REVIEW OF CREDIT UNION TAX EXEMPTION

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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THURSDAY, NOVEMBER 3, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 10:44 a.m., in room 1100, Longworth House Office Building, Hon. Bill Thomas, (Chairman of the Committee), presiding.

[The advisory and revised advisory announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
October 27, 2005
No. FC–15

CONTACT: (202) 225–1721

Thomas Announces Hearing on Review of Credit Union Tax Exemption

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing titled, "Review of Credit Union Tax Exemption." **The hearing will take place on Thursday, November 3, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Invited witnesses will include representatives from the U.S. Government Accountability Office, the Internal Revenue Service, the National Credit Union Administration (NCUA), as well as academic experts and other interested parties. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

In 1934, the Federal Credit Union Act (FCUA) (P.L. 73–467) was signed into law, establishing a charter for Federal credit unions. Three years later, Congress provided for statutory tax exemption for Federal credit unions. At the time when the FCUA was enacted, there were approximately 2,350 credit unions operating in the United States with approximately 450,000 members and assets of $50 million. At the end of 2004, there were 9,483 credit unions with about 86.9 million members and assets totaling more than $674 billion dollars.

There are varying explanations for why Congress granted tax-exempt status to credit unions. The most recent explanation can be found in the Credit Union Membership Access Act in 1998 (P.L. 105–219), where Congress stated in its findings that credit unions are tax-exempt because they "are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

Under current law, Federal credit unions are tax-exempt under section 501(c)(1) of the Internal Revenue Code (IRC). In order for a Federal credit union to be recognized as tax-exempt it needs to be chartered by the NCUA. State credit unions are tax-exempt under section 501(c)(14) of the IRC. This provision requires that the credit union not have capital stock, and that it be organized and operated for mutual purposes and without profit.

Credit unions are limited under their authorizing legislation both in terms of who they may serve and the services they offer. However, as credit unions have grown over time, they have been allowed to expand their range of services and their fields of membership. Some have questioned whether these changes in the credit union industry mean that many credit unions do not serve the goals for which the tax exemption was granted.

The hearing will examine the following issues:

- The history of and Congress' rationale for providing tax exemption to credit unions;

- Whether credit unions are serving the goals intended with their tax-exempt status;
- The use of the tax benefit by credit unions; and
- Changes in the credit union industry, including the growth in credit union membership and services.

In announcing the hearing, Chairman Thomas stated, "This hearing continues the Committee's examination of the tax-exempt sector. When credit unions were granted their tax exempt status, they provided an important benefit to people of modest means. Credit unions have been statutorily tax-exempt for almost 70 years now, and it is important that Congress understand whether there is a strong justification for the tax exemption. Congress has an obligation to ask questions to ensure that the country is receiving something in exchange for the benefit of tax exemption."

FOCUS OF THE HEARING:

The hearing will examine the legal history of the tax exemption for credit unions, to determine whether credit unions are serving the goals intended with their tax-exempt status.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "*submit*" on the final page, an e-mail will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Thursday, November 17, 2005. **Finally,** please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
November 03, 2005
No. FC–15–Revised

Change in Time for Hearing on Review of Credit Union Tax Exemption

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee hearing titled, "Review of Credit Union Tax Exemption," previously scheduled for 10:00 a.m. on Thursday, November 3, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, ***will now be held at 10:30 a.m.***

All other details for the hearing remain the same. (See Full Committee Advisory No. FC–15, dated October 27, 2005).

Chairman THOMAS. If we could ask our guests to find seats, please. Today, the Committee continues its series of oversight hearings on the tax-exempt sector. At this hearing we will focus on the tax-exemption provided to Federal and State credit unions. Credit unions have been statutorily tax-exempt for almost 70 years. Today, they have approximately 87 million members and combined assets of more than $674 billion. Yet, their tax status has received little scrutiny from Congress. In fact, this is the Committee's first hearing in 20 years devoted exclusively to credit union tax-exemption. Based upon e-mails sent around, newspaper articles generated and statements made, it appears as though some people think it is an affront to have the Committee ask the people who receive a benefit from the taxpayers of this country to come in and answer a few questions. They have even gone to the extent of apparently setting up a countdown calendar on how long I am going to remain chairman and how long they need to hunker down.

Mr. RANGEL. How did that turn out?

Chairman THOMAS. Several credit unions—far longer than you ever wanted it to, Charlie.

[Laughter.]

Mr. RANGEL. I just asked.

Chairman THOMAS. I just answered. We are going to hear over and over that Federal credit unions were created in 1934, and then received their tax-exempt status in 1937. But what I really want to do, since many people do not remember the banking structure from 1934 and 1937 and what it looked like at that time, that was the era in which the industry was examined and credit unions were established, because, no question, based upon the statute, Americans of modest means had difficulty obtaining credit at that time. Over the last 70 years, however, the financial service industry as a whole, and credit unions specifically, have changed a great deal. That is why it is important to periodically revisit the field and see if what did apply continues to apply. Or in evolving, in meeting those changing needs, the evolution, in fact, makes sense to the taxpayers who provide a very generous subsidy.

If you examine what a credit union was when it first started and look at what credit unions are today, especially those that are the newest in emerging credit unions, you find out that you can have a credit union which is called the Congressional Federal Credit Union but supplies credit to a retail restaurant, to Legal Seafood, and to a law firm called Akin Gump, notwithstanding the fact it is called a "congressional credit union." When you deal with community charters, whatever local means, I find it somewhat amazing that a credit union can be chartered to have as its local community the county of Los Angeles, which has a population greater than 42 States in the country. While the original credit unions offered limited services, many modern credit unions offer a wide variety of services. Increasingly credit unions are offering business loans to members, and through some affiliates, credit unions offer services that seem to be quite unrelated to their original mission. For example, health and dental insurance, automobile sales, or even pet insurance.

So, as we begin to look at this, one of the concerns I have is not so much, although we will inquire, about the question of what is it that they do to continue to get the tax-exempt status. For example, when we examined nonprofit hospitals, we found that at one time they were required to provide services to the poor. That was eliminated sometime ago—hospitals are not even required to do that. However, I do think it should be noted that the original statement from the thirties offering people of modest means financial services was restated as recently as 1998 in legislation. So, that seems to be an ongoing theme. The concern that I have in today's world, as many of us were shocked in terms of things that were occurring in the corporate world, are focused primarily on the question of transparency, accountability, verifiability, the sorts of things that taxpayers if they were sitting here today would want to know to determine whether or not they are getting their money's worth in terms of not just the activities or the services that credit unions provide, but the way in which they are run, who gets the benefits, to what extent they have a comfort level that the accounting procedures are aboveboard, and match up to some of the new accounting procedures that Congress has passed on to entities that pay taxes. So, that is really the direction that Congress ought to engage in once every two decades. With that, I recognize the gentleman from New York for any statement he would like to make.

Mr. RANGEL. Thank you, Mr. Chairman. Seventy-five years ago, a great concept came into being, and as a result of that, the lives of people have improved throughout the United States and, indeed, throughout the world, because 75 years ago, Charlie Rangel was born, and he certainly has made a difference.

[Laughter.]

Mr. RANGEL. Of course, at the same time credit unions were created, and so those were two great things that happened 75 years ago. It seems as though that they provided a great service to many people, and right here at Wright Patman I see the long line of members who are anxious to receive services here. I, like the chairman, welcome these positive, motivated hearings to see what we can do to improve the quality of service that we render. So, it is very interesting that hospitals would be on the same line of interest to the Chair that is the not-for-profits. But we do hope that at the end of this administration, if the public does not provide the service and we have not-for-profits providing the service, that something would be left for those people that are not among the powerful as relates to their lobbying interests. So, Mr. Chairman, let me thank you for openly having these hearings so that at least those of us who appreciate the great work that hospitals are doing and the credit unions are doing, we are able to let our constituents know the direction in which you are going. I reserve any other comments I might have.

Chairman THOMAS. I thank the gentleman. Our first panel today consists of the Honorable Mrs. Johnson, who is the Chairman of the National Credit Union Administration (NCUA); Steven T. Miller, Commissioner in the Internal Revenue Service, who has visited with us before; and Richard J. Hillman, who is the Managing Director, Financial Markets and Community Investment, U.S. Government Accountability Office, who has visited with us as well. Each of you has submitted written testimony, and it will be made a part of the record, without objection. The Chair and the Members look forward to hearing from each of you present the information you have, in any manner you see fit in the time that you have available to you. Let's start with Chairman Johnson and move across the panel.

STATEMENT OF HON. JOANN JOHNSON, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION, ALEXANDRIA, VIRGINIA, ACCOMPANIED BY ROBERT FENNER, GENERAL COUNSEL, NATIONAL CREDIT UNION ADMINISTRATION

Ms. JOHNSON. Chairman Thomas, Ranking Member Rangel, and Members of the Committee, on behalf of the National Credit Union Administration, thank you for the opportunity to be here today to present NCUA's views on the credit union tax-exemption. The NCUA acknowledges the support of this and previous Administrations, and also of Congress, favoring the continued tax-exemption for credit unions as important public policy. The NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. We fulfill this mission by examining, regulating, and insuring all Federal credit unions. In coordination with the State regulators, we participate in the supervision of federally insured State-chartered credit unions. As credit union cooperatives, federally insured credit unions vary in size. However, their cooperative structure and purpose is identical. They are strongly capitalized and present minimal risk to the National Credit Union Share Insurance Fund, the Treasury, and ultimately the American taxpayers. The Share Insurance Fund has never required taxpayer support. It is from this perspective that we have reviewed the implications of the debate over continuing the credit union tax-exemption.

Credit unions are today, as they were at their inception in the United States, member-owned, democratically controlled—that is, one member, one vote, and a volunteer board—tax-exempt cooperatives, fulfilling their mission of serving the credit and savings needs of consumers, especially those of modest means. This structure, begun as a financial service provider for the working Americans, remains intact today as credit unions fulfill their purpose of serving a broader base of American consumers, especially those of low and moderate income, even as both credit unions and other financial institutions have adapted to consumer demand for improved delivery of financial services. It is through this cooperative structure that the credit union system provides billions of dollars in annual benefits to consumers. The structure supports the incentive of credit unions to provide affordable services to their consumer owners rather than to maximize profits to outside investors or stockholders.

Though credit unions comprise only 6 percent of federally insured institutions' assets, essentially the same level since 1992, the effect of this minimal competition also assures better rates and services for users of all financial institutions. Critical to this discussion, it is the agency's view that credit unions are fulfilling their mission of serving persons of modest means. Over 1,000 credit unions exist specifically for the purpose of serving designated low-income fields of membership. Additionally, 640 Federal credit unions as well as many State-chartered credit unions have added underserved areas to their fields of membership. Industry-wide, savings and loan balances in credit unions are lower than in other institutions. Credit unions make a higher percentage of their HMDA-reported loans to low- and moderate-income borrowers than do other institutions. These and other facts reported in my written statement demonstrate that credit unions are actively fulfilling this aspect of their mission. Credit unions have modernized their methods of delivering services. This has been appropriate. It has been necessary for their survival, and it is consistent with the principle that those of modest means should not be restricted to modest services.

Also important to this analysis is the fact that credit unions build capital only by setting aside a portion of their earnings. Taxation threatens to diminish that sole source of capital, resulting in changes that could undermine the continuation of the cooperative credit union system. When subjected to the additional expense of taxation on net worth in conjunction with the limitations on membership and powers, it may be difficult to justify retaining a cooperative credit union charter. A likely response, especially for larger credit unions, will be to convert to bank charters. The present structure is successfully serving 84.5 million credit union members and empowers many Americans, especially those outside the financial mainstream, to be introduced to the financial services marketplace. It is the same success that argues most strongly for the retention of this important statutory mandate if a viable financial alternative is the desired result. Due to their unique cooperative structure and in the interest of maintaining it, credit unions have had tax-exempt status since 1917. This status was affirmed and formally codifies for Federal credit unions in 1937 and reaffirmed by Congress in both 1951 and 1998. In 2001, the Treasury department reviewed, along with several other issues, the credit union tax-exemption. The resulting report offered now administrative or legislative changes regarding the exemption.

The original justification for tax-exempt status remains valid. federally insured credit unions provide billions of dollars of benefits annually to all consumers, not just credit union members, by assuring that competitive rates are offered in the financial marketplace. Congress should carefully consider these facts in determining whether to repeal the credit union tax-exemption. Thank you for the opportunity to participate on the panel, and I will be happy to address questions. Thank you.

[The prepared statement of Ms. Johnson follows:]

Statement of Hon. JoAnn Johnson, Chairman, National Credit Union Administration, Alexandria, Virginia, accompanied by Robert Fenner, General Counsel, National Credit Union Administration

Chairman Thomas, Ranking Member Rangel and Members of the Ways and Means Committee: on behalf of the National Credit Union Administration ("NCUA"), thank you for the opportunity to be here today to present the Agency's views on "A Review of the Credit Union Tax Exemption." NCUA recognizes and supports this and previous Administrations' and Congressional policy favoring the continued tax exemption for credit unions as important public policy.

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public policy function by first examining and insuring all Federal credit unions, and second, in coordination with the state regulators, participating in the supervision of federally insured state chartered credit unions. In its capacity as the administrator for the National Credit Union Share Insurance Fund ("NCUSIF"), NCUA provides oversight and supervision to approximately 8,800 federally insured credit unions, representing over 96 percent of all credit unions and 84.5 million credit union members. As credit union cooperatives, federally insured credit unions vary in size; however, their cooperative structure and purpose is identical. They are strongly capitalized and present minimal risk to the NCUSIF, the Treasury and ultimately to the American taxpayers. The NCUSIF has never required taxpayer support.

Especially important to this discussion on credit union tax exemption is the Federal law that specifies strict system capital ("net worth") standards known as Prompt Corrective Action. By law, written and overseen by the Financial Services Committee, federally insured credit unions are alone among insured financial institutions in how they can build and maintain net worth. Specifically, they are limited to using only their retained earnings to meet their statutory capital requirements. Taxation threatens to diminish that sole source of capital by reducing the ability to generate net income and cause other adverse changes. Eventually, as credit union net worth ratios decline to levels that require additions to retained earnings in order to meet statutory and regulatory capital requirements, taxation may result in behavior modifications that could undermine the continuation of the cooperative credit union system.

Any consideration of repealing the credit union tax exemption should include a very careful analysis of the effects on the public policy benefits of the credit union system. From our standpoint as the insurer of member share accounts and the safety and soundness regulator for federal credit unions, NCUA believes that a thorough analysis leads to the firm conclusion that the tax exemption is sound Congressional policy and should remain in place if Congress desires to preserve the cooperative structure most capable of providing financial services to people of modest means.

In 2001, the Treasury Department reviewed, along with several other issues, the credit union tax exemption. The report offered no administrative or legislative changes regarding the exemption.[1]

[1] U.S. Department of the Treasury *"Comparing Credit Unions and other Depository Institutions"* (January 2001).

The billions of dollars in annual consumer benefits provided by credit unions are derived by the credit union structure being member owned, democratically controlled, tax-exempt cooperatives. This cooperative structure supports the organizational incentive of credit unions to provide affordable services to their consumer owners, rather than to maximize profits to outside investors or stockholders. Though credit unions comprise only a small segment of the financial services marketplace, approximately six percent of federally insured institutions' assets, the effect of this minimal competition assures better rates and services for users of all financial institutions.

The cooperative structure has remained unchanged since the inception of credit unions in the United States as financial cooperatives for working Americans, and, most importantly, it remains intact today as credit unions fulfill their purpose of serving a broader base of American consumers, especially those of low and moderate income. It is a structure that has remained unchanged as other financial intermediaries have entered the consumer financial services market, and as both credit unions and others have adapted to consumer demand for change in the methods of delivery of financial services.

Review of this issue leads NCUA to conclude that repeal of the tax exemption may have consequences not intended by Congress, including altering the delivery of financial services to a broad range of Americans.

A likely response to taxation, for many credit unions, would be to convert to bank charters. It may be difficult to justify retaining a cooperative credit union charter, with the associated limitations on membership and powers in conjunction with higher capital requirements, when subjected to the additional expense of taxation. The history of the mutual thrift industry and recent developments in the credit union system demonstrate there are financial incentives for management to convert their cooperative charters to bank charters. The probable effect of taxation would be to accelerate these conversions. The remaining credit unions subject to taxation will also likely seek expanded authorities and the removal of currently imposed limitations to offset the expense of taxation. The combined effect of these trends would clearly threaten the existence of the cooperative not-for-profit credit union system.

The tax-exempt status of credit unions has enabled these institutions to provide Americans from all walks of life to have greater access to affordable financial services. The present structure is successfully serving 84.5 million credit union members and empowers many Americans, especially those outside the financial mainstream, to be introduced to the financial services marketplace. It is this same success that argues most strongly for the retention of this important statutory mandate if a viable financial alternative is the desired result.

It is because of their unique cooperative structure, and in the interests of maintaining it, that credit unions have had tax-exempt status since 1917. This status was affirmed and formally codified for federal credit unions in 1937, and reaffirmed by Congress in both 1951 and 1998. The original justification for tax-exempt status remains valid, and should not be changed if Congress wishes to maintain a financially sound, cooperative credit union system.

CREDIT UNIONS ARE UNIQUE

Credit unions are distinguishable from other financial institutions in their structural and operational characteristics. As the U.S. Treasury Department noted in their 2001 study of credit unions:[2]

Many banks and thrifts exhibit one or more of the following five characteristics; ***but only credit unions exhibit all five together***.

First, credit unions are member-owned, and each member is entitled to one vote in selecting board members and in certain other decisions. Although other mutual institutions are also member-owned, voting rights are generally allocated according to the size of the mutual member's deposits, rather then being "one member, one vote."

Second, credit unions do not issue capital stock. Credit unions create capital, or net worth, by retaining earnings. Most credit unions begin with no net worth and gradually build it over time.

Third, credit unions rely on volunteer, unpaid boards of directors whom the members elect from the ranks of membership.

Fourth, credit unions operate as not-for-profit institutions, in contrast to shareholder-owned depository institutions. All earnings are retained as capital or returned to the members in the form of interest on share accounts, lower interest rates on loans, or otherwise used to provide products or services.

[2] Id. at 6–7 (January 2001) (citations omitted) (emphasis added).

Fifth, credit unions may only accept as members those individuals identified in a credit union's articulated field of membership. Generally, a field of membership may consist of a single group of individuals that share a common bond; more than one group, each of which consists of individuals sharing a common bond; or geographical community. A common bond may take one of three forms: an occupational bond applies to the employees of a firm; and associational bond applies to members of an association; and a geographical bond applies to individuals living, working, attending school, or worshipping within a particular defined community.

While credit unions provide many of the basic services that one would expect from a depository institution, including share (deposit) accounts, share draft (checking) accounts, personal loans, auto loans, mortgages, and small business loans, Congress limited the permissible activities of federal credit unions in many areas.

These limitations serve to illustrate the very real differences compared to other depository institutions. These include, among other things, limitations on lending and investment authorities, rates of interest they may charge, constraints on capital, and field of membership restrictions.

In addition to their distinctive structure and services, the basic role of credit unions is also very different from that of banks and thrifts. Most importantly, credit unions, unlike banks, are not motivated by profit or the desire to maximize the investment of their stockholders. Rather, credit unions focus on the mission of serving their members and enabling them to receive loan and share (deposit) rates on favorable terms. Pursuant to the Federal Credit Union Act, a federal credit union is specifically defined as "a cooperative association organized—for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes . . ."[3]

Throughout the history of credit unions in the United States, credit unions have been one of the first sources of financial services to working people. Many credit unions established their first offices within faith-based organizations, association halls, steel mills, factories, military bases, and other work places, providing basic, and later expanded, financial services to those not within the mainstream of the financial marketplace. In many instances, credit unions had been the only alternative to payday lenders, pawn shops, or loan sharks.

As industry and the economy changed, communities expanded through improved transportation, and social and associational organizations waned in the United States, credit unions necessarily adapted in order to continue to fulfill their mission of providing cooperative financial services.

With various industries shuttering their plants, credit unions relocated their offices outside of the work locations in order to continue serving their members. Many of these members, victims of plant closings and job losses in a shifting economy, became small business owners, with credit unions willingly providing the first source of capital to their venture. Many of these small business owners could not provide the same benefits received from large industrial companies, but still pursued the opportunity of providing the benefit of credit union ownership and financial service to their employees.

Credit unions, like all financial institutions, have evolved to meet the basic financial needs of their members. Credit unions provide the financial services now available due to changing and improving technology while remaining true to the cooperative structure. They have successfully provided these services without abandoning their unique structure as member-owned, democratically controlled cooperatives. An underlying tenet to these advances was, and continues to be, the belief that those of modest means should not be restricted to modest services.

HISTORY OF THE CREDIT UNION TAX EXEMPTION

The cooperative nature of credit unions was the original basis for the credit union tax exemption. Importantly, credit unions have not abandoned this statutory mandate.

When credit unions first appeared in this country they were purely creations of state law, and thus, until the passage of the Federal Credit Union Act in 1934, there were only state chartered credit unions. When a federal income tax was first passed, credit unions were not specifically exempted from tax, although other classes of organizations conducted for the mutual benefit of individuals were exempted. Credit unions received tax-exempt status in 1917, pursuant to an administrative ruling issued by the U.S. Attorney General. In his ruling, the Attorney General found that the tax exemption for these other organizations extended to credit unions as they "are organized and operated for mutual purposes and without profit."[4]

[3] 12 U.S.C. § 1752(1).
[4] 31 Op. Atty. Gen. 176 (1917).

With the passage of the Federal Credit Union Act in 1934, the federal credit union charter was created. Though the Act did not specifically create a tax exemption for this new federal charter, the Attorney General's ruling was extended to effectively provide an exemption. This exemption, however, did not apply to the taxation of federal credit unions by states in which the credit union is located. States could tax federal credit unions as long as the tax was in the same manner and did not exceed the rate imposed on other domestic banking corporations.[5]

In 1937, the Federal Credit Union Act was amended to create a specific tax exemption for federal credit unions.[6] In his testimony in support of the tax exemption, the Governor of the Farm Credit Administration (who supervised federal credit unions at the time) stated:

Many States tax domestic banking corporations in relation to their share capital. In view of the fact that federal credit unions may not accept deposits, their share capital represents a much greater proportion of their total resources than is the case in other financial institutions. Experience with Federal credit unions since the passage of the original act indicates that such taxation, therefore, places a disproportionate and excessive burden on them. Furthermore, these credit unions are mutual or cooperative organizations operated entirely by and for their members and in view of this fact it is appropriate, we feel that local taxation should be levied on the members rather than the organization itself.[7]

A Report from the U.S. House of Representatives delineated two reasons for ultimately granting federal credit unions a tax exemption. First, they found that taxing credit unions on their shares (deposits) in the manner that banks are taxed on their capital shares places a disproportionate and excessive burden on credit unions, because credit union shares function as deposits. Second, they found that credit unions are mutual or cooperative organizations operated entirely by and for their members.[8]

Pursuant to the changes made in 1937 the Federal Credit Union Act currently exempts all federal credit unions from:

. . . all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such Federal credit union shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed.[9]

Thus, federal credit unions were exempted from most, but not all taxes. This is the current state of the tax exemption for Federal credit unions.[10]

For many years credit unions were not the only depository institutions exempted from taxation. Among others, mutual savings banks and savings and loan associations were also exempted. In 1951, Congress found that mutual thrifts had essentially lost the essence of their mutuality. Accordingly, mutual savings banks and savings and loan associations lost their tax exemption. However, the exemption for federal credit unions was left intact, and expresses statutory tax-exempt status was afforded to state-chartered credit unions, essentially affirming that credit unions remained true to their cooperative nature.

In 1998, the tax treatment of credit unions was again affirmed. The Credit Union Membership Access Act of 1998 stated the findings and intent of Congress with respect to the tax exemption:

Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not for profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.[11]

CREDIT UNIONS' MARKET SHARE HAS REMAINED CONSTANT

More diversified fields of membership in both multiple group and community charters means that individual credit unions are more diversified in their loan assets and therefore present less risk to the NCUSIF. This is contrasted with the historical predominance of single-employer common bonds, which increased safety and soundness problems in the credit union system in the 1970s when numerous indus-

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[5] Pub. L. No. 467, c. 750, 48 Stat. 1216 (June 26, 1934).

[6] Pub. L. No. 416, c.3, § 4, 51 Stat. 4 (December 6, 1937).

[7] Testimony of Governor Meyer, Farm Credit Administration before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 75th Cong., 1st Sess. (May 11, 1937).

[8] H.R. REP. NO. 1579, 75th Cong., 1st Sess. P.2.

[9] 12 U.S.C. § 1768.

[10] This section of the Federal Credit Union Act was amended in 1959, however, the changes did not affect this particular part of the section.

[11] Pub. L. No. 105–219, 112 Stat. 913 (August 7, 1998).

trial companies failed and their "single sponsor" credit unions followed suit as unemployed members defaulted on their loans.

Moreover, recent trends in field of membership expansions, including both conversions to community charters and expansions by adding underserved areas, allow credit unions to do a better job of fulfilling their historic and important mission of serving persons of modest means. Thus, recent field of membership trends have both reduced risk in the credit union system and enabled credit unions to better fulfill their statutory purpose.

With this success, however, credit unions are not gaining market share at the expense of banks and thrifts. In 2004, federally insured credit unions held merely six percent of total financial industry assets; essentially the same level since 1992. While the percentage of industry assets held by smaller banks and thrifts is declining, this decrease did not result in an increase in market share for credit unions. The combined assets of all federally insured credit unions as of December 31, 2004—$647 billion in total—are less than the total assets of any of the three largest banks as of December 31, 2004.[12]

(Image not available)

Source: FDIC financial call report data, NCUA financial call report data

Along with a limited market share, the size of the credit unions within the system remains small. Average and median asset size of federally insured credit unions—as of June 30, 2005—reflects an average asset size of $75.5 million and a median asset size of less than $12 million in assets.

All Federally Insured Credit Unions (FICUs)

As of June 30, 2005

	# of FICU	% of Total	Assets	% of Total
<$10 Million	4,097	46.2%	15,396,929,628	2.3%
$10–$50 Million	2,810	31.7%	66,684,864,271	10.0%
$50–$100 Million	774	8.7%	54,445,882,179	8.1%
$100–$500 Million	922	10.4%	198,115,394,051	29.6%
$500 Million–$1 Billion	155	1.7%	105,889,848,338	15.8%
$1–5 Billion	97	1.1%	166,321,482,089	24.8%
>$5 Billion	6	0.1%	62,861,279,695	9.4%
Total	8,861	100.0%	669,715,680,251	100.0%

CREDIT UNIONS ARE SERVING PEOPLE OF MODEST MEANS

Federal credit unions were formed during the height of the great depression to provide working people with access to affordable financial services through a cooperatively owned financial institution. This type of financial institution provided workers an opportunity to save a portion of their wages and have access to reasonably priced loans for "provident and productive purposes."

Credit unions have not deviated from their original structure and purpose, providing their members with an opportunity to improve their financial well-being through share and loan products designed to meet their financial needs in an ever changing financial and economic environment. The ability to meet the statutory purpose is dependent on a number of factors, including diversification of fields of membership.

Recognizing the difficulty credit unions encounter in serving a greater proportion of low and moderate income members Congress, in 1970, established authority for low-income designated credit unions to accept non-member share deposits. This authority, which by NCUA regulation is available to credit unions who serve a majority of members with a median household income at or less than 80% of the national median household income, provides qualifying credit unions with an ability to raise

[12] Source: http://www.fdic.gov. As of December 31, 2004, JP Morgan Chase Bank, N.A. had $967.3 billion in assets, Bank of America, N.A. had $771.6 billion in assets and Citibank, N.A. had $694.5 billion in assets.

share deposits from outside of the credit union's membership to support further lending, products and services to their members.

Currently, approximately 12% of credit unions have received this designation from the NCUA. These more than 1,000 credit unions are providing their members the financial services identified as best meeting their needs at an affordable cost.

Since 1994, NCUA regulations have authorized all Federal credit unions to add underserved areas to their fields of membership, using the terminology "low income communities." In 1998, the Credit Union Membership Access Act was passed which authorized multiple group chartering previously overturned by the Supreme Court. In this Act, Congress recognized the authority of multiple group credit unions to serve "underserved areas" and established a specific definition for that term. For consistency, NCUA regulations were revised to apply this terminology to all credit unions when adding low income areas in need of service. Since 1999, more than 650 federal credit unions have added 1,406 underserved areas to their fields of membership. This authorization has allowed credit unions to serve low and moderate income areas and facilitate affordable financial services to individuals who often have been left behind to predatory lenders. Many of these credit unions are of a sufficient asset size to provide these underserved areas with improved and an expanded array of financial products and services at reasonable costs.

NCUA has also done much to encourage credit unions to serve the unbanked and those of low and moderate income. NCUA's Access Across America Initiative promotes the benefits of the low-income designation for eligible credit unions and encourages credit unions to make use of the "underserved area authority." Also, NCUA established in the mid-1990s the Economic Development Specialist ("EDS") position to further credit union service in low-income and underserved areas. In 2001, the NCUA Board established a national small credit union program initiative and centralized the EDS position to the newly created Office of Small Credit Union Initiatives. Presently there are 15 EDS positions dedicated to working with groups interested in chartering credit unions and those credit unions serving or interested in serving members in underserved areas. This office also conducts workshops throughout the nation that provide smaller credit unions with best practices, potential service opportunities, and technical assistance on operations and staff training.

Based on recent financial information collected by the NCUA in our quarterly call reports, average and median share deposit and loan balances in the credit union system demonstrate credit unions are serving members who hold low share deposit and loan balances. Of greater significance is the comparison of average and median share deposit and loan balances between low-income designated credit unions and the total population of federally insured credit unions. In general, average and median balances in federally insured credit unions mirror those in low-income designated credit unions.

Average and Median Credit Union (CU) Share Deposit Balances

As of June 30, 2005

All Federally Insured CUs	Share Deposits	Share Drafts	Money Market	Share Certificates	IRA/ Keogh	All Other Shares	All Shares
Average Balance	3,293	2,491	23,127	17,320	11,110	40,440	3,279
Median	2,916	2,028	21,034	13,186	9,866	824	2,905
Low-Income CUs							
Average Balance	2,417	1,818	23,645	15,476	10,797	1,738	2,354
Median	2,126	1,558	20,249	12,135	10,003	695	2,086
All Community CUs							
Average Balance	3,037	1,969	22,198	14,881	10,371	3,034	2,999
Median	2,891	1,764	21,191	13,461	9,527	807	2,863

Average and Median Credit Union (CU) Loan Balances

As of June 30, 2005

All Federally Insured CUs	Loans/ Leases	Cred-it Card	Other Unse-cured Loans	New Vehicle	Used Vehi-cle	1st Mort-gage	Other Real Estate	All Other Loans
Average Balance	8,046	1,466	2,659	13,930	8,217	79,620	27,561	8,221
Median	7,089	1,344	2,287	14,074	8,142	66,809	24,836	6,162
All Low Income CUs								
Average Balance	6,327	1,256	2,293	13,679	7,396	49,818	26,387	7,637
Median	5,800	1,150	1,999	13,919	7,371	42,085	22,950	5,253
All Community CUs								
Average Balance	8,732	1,420	2,415	14,592	8,216	72,277	26,443	8,341
Median	8,124	1,302	2,169	14,592	8,152	61,779	24,588	6,630

The discrepancy between federally insured credit unions and low-income designated credit unions on average and median first mortgage balances seems to indicate federally insured credit unions make larger loans. However, based on data gathered from the Census Bureau's American Housing Survey for the United States completed in 2003, the median mortgage loan balance is $82,010 for all occupied residential units compared to the $66,809 reported for median mortgage loan balances for federally insured credit unions. This information shows federally insured credit unions holding smaller balanced first mortgage loans. Collectively, the data supports the conclusion federally insured credit unions grant many smaller-balanced loans and are, therefore, serving members requesting lower balanced loans.

Home Mortgage Disclosure Act ("HMDA") data also reflects the continued focus of credit unions on making credit available to borrowers of low and moderate means. As shown in the following table containing 2003 HMDA data, credit unions deny fewer loans to both minority and white borrowers than other financial institutions. Although serving a smaller market base, credit unions focused on reaching out to all segments of their membership.

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2003 HMDA Data Mortgage Denial Rates

		White	Tot Min	Am Ind	Asian	Black	Hisp	Joint	Other	N/A	Total
OCC	Applications	6,373,248	1,931,002	33,509	377,521	532,776	632,830	221,805	132,561	1,086,700	9,390,950
1,091	Denial Rate	12.1%	21.8%	25.0%	12.0%	28.5%	25.6%	12.5%	18.2%	18.0%	14.9%
FRB	Applications	1,916,573	511,367	6,794	89,451	155,796	183,974	50,648	24,704	353,173	2,781,113
565	Denial Rate	9.1%	18.1%	19.7%	10.1%	22.2%	21.0%	9.3%	15.2%	14.8%	11.6%
FDIC	Applications	1,859,365	403,427	7,108	78,147	111,072	143,839	41,755	21,506	248,342	2,511,134
2,587	Denial Rate	10.1%	19.7%	20.6%	12.8%	27.6%	19.5%	11.8%	17.5%	19.8%	12.7%
OTS	Applications	2,993,023	968,616	10,435	236,263	227,144	345,828	96,002	52,944	637,048	4,598,687
674	Denial Rate	10.3%	17.7%	18.5%	13.3%	22.0%	19.1%	12.0%	17.7%	17.0%	12.8%
NCUA	Applications	685,145	161,138	3,656	24,851	51,469	43,925	30,013	7,224	138,853	985,136
1,920	Denial Rate	5.5%	13.2%	11.6%	7.5%	18.0%	15.2%	6.5%	12.6%	11.5%	7.7%
HUD	Applications	5,825,625	2,883,838	46,476	330,703	893,277	1,005,229	255,504	352,649	3,045,896	11,755,359
1,181	Denial Rate	19.6%	26.4%	30.5%	15.0%	31.2%	21.8%	17.6%	42.7%	29.5%	23.9%
National	Applications	19,652,979	6,859,388	107,978	1,136,936	1,971,534	2,355,625	695,727	591,588	5,510,012	32,022,379
8,018	Denial Rate	13.5%	22.5%	25.6%	13.0%	28.1%	22.1%	13.8%	32.6%	24.0%	17.2%

In fact, as reported in the 2005 National Community Reinvestment Coalition paper, "Credit Unions: True to Their Mission?", HMDA data for calendar year 2003 shows that credit unions made a higher percentage of single family mortgage loans to low and moderate income borrowers (24.2% compared to 23.2%) than banks. In addition, credit unions significantly increased home purchase loans to low and moderate income borrowers to 28.3% of their loan portfolios at 2003 from 23.6% at 2001, while bank lending in this area stayed relatively constant (28.6% in 2001 and 28.9% in 2003).

In recent years, legislative, regulatory, and policy changes have resulted in more credit unions serving communities with low and moderate income borrowers. In fact, NCUA data demonstrates that credit unions are reaching out to serve low-income residents and are adopting underserved areas into their fields of membership. Those credit unions that have adopted underserved areas have more than doubled their membership growth as compared to the credit union system as a whole.

As members from these areas become familiar with the products and services offered, credit unions will likely receive more loan applications and further improve their penetration of the low and moderate income lending market.

NEED FOR THE CONTINUATION OF THE TAX EXEMPTION

Credit unions are tax-exempt because of their cooperative structure and not-for-profit mission. While this cooperative structure, and not the other limitations on powers, is what entitles credit unions to a tax exemption, it is important to note that these limitations restrict credit union activities compared to other types of depository institutions. Despite these limitations, the tax exemption offers an incentive for credit unions to remain true to their mission of serving members of all income levels. If credit unions' tax status was changed, credit unions would have less incentive to remain credit unions. If these not-for-profits were to be taxed, many credit unions would probably choose to convert to other types of institutions in order to have expanded powers. Without credit unions, predatory lenders may become the financial service provider by default for many Americans who now rely on credit unions for essential credit union services.

An exodus of the larger, well-capitalized credit unions would have a detrimental effect on the entire credit union system. These institutions provide a support structure for the entire credit union system, as demonstrated in the aftermath of Hurricanes Katrina, Rita, and Wilma.

Credit unions provide support to one another through credit union service organizations, shared branching networks, other partnership arrangements, and credit union league supported programs. If significant numbers of larger credit unions depart the system, the pressures related to earnings and capital accumulation would increase significantly for those credit unions remaining within the system. This may result in an increase in the number of credit union failures.

Loss of critical mass of larger credit unions may also result in the credit union system no longer being economically viable. The largest 13% of federally insured credit unions (over $100 million in assets) hold almost 80% of the system's assets. Conceivably, 87% of all federally insured credit unions would remain, but these would only hold 20% of the current financial resources of the system.

The potential costs to the credit union system outweigh any anticipated revenue gains that may be realized by taxing credit unions. Estimates put annual tax revenue gains at between $1.2 billion to $1.5 billion annually.[13] Using cost benefit analysis, leaving aside the mission of serving those of modest means, the dollar return to consumers and the economy far exceed these tax revenue estimates. One recent study of North Carolina financial institutions estimated that each credit union member saves $130 a year through lower loan rates, lower fees, and higher returns on savings.[14] If applied to all members nationally this would equate to $11 billion in savings passed on to credit union members.

Finally, if credit unions are taxed, all consumers, not just credit union members, will be detrimentally affected. It is estimated that by losing the positive influence of credit unions, bank customers will pay an additional $4 billion in higher rates, higher fees, and lower returns on deposits.[15] This is in addition to a decline in serv-

[13] U.S. Department of the Treasury "*Comparing Credit Unions and other Depository Institutions* " at 32 (January 2001); Congressional Budget Office, "*Budget Options* " at 301 (February 2005).

[14] The University of North Carolina at Chapel Hill, William E. Jackson III, *"The Benefits of Credit Unions to North Carolina Consumers of Financial Services,"* at 3 (April 2005).

[15] The American University, *"An Analysis of the Benefits of Credit Unions to Bank Loan Customers,"* (September 2004); Idaho State University, *"An Estimate of the Influence of Credit Unions on Bank CD and Money Market Deposits in the U.S.,"* (January 2005).

ice quality and convenience, reduced access to basic financial services, and no check on the proliferation of predatory financial service providers.

CONCLUSION

Credit unions exist for the purpose of promoting thrift and providing a source of credit for their members. Since their inception, credit unions have been organized as democratically controlled, not-for-profit cooperatives, managed by a volunteer board of directors elected by and from the membership. These characteristics define the uniqueness of credit unions that serves as the basis for their tax exemption. All of these characteristics are as true today as they were almost a century ago when the tax exemption was first extended to credit unions.

As recently as 1998, Congress noted that the credit union system began as a cooperative effort to serve the credit needs of individuals of modest means, and that credit unions continue to fulfill that public purpose. Field of membership policy changes since 1998, and associated trends in charter expansions, have served to fulfill this special mission. Credit unions of all sizes continue their tradition of supporting one another through service organizations, shared branching networks, participation lending, inter-credit union deposits, technical assistance, and other methods of ensuring continuation of service to all segments of their membership, including low and moderate income members.

Federally insured credit unions provide billions of dollars of benefits annually to consumers by assuring that competitive rates and services are offered in the financial marketplace. Repeal of the tax exemption would result in pressure on credit unions to move away from their not-for-profit cooperative structure causing a systemic risk throughout the system. Congress should carefully consider these implications in determining whether to repeal the credit union tax exemption.

Chairman THOMAS. Thank you, Chairman Johnson. Mr. Miller?

STATEMENT OF STEVEN T. MILLER, COMMISSIONER, TAX-EXEMPT AND GOVERNMENT ENTITIES DIVISION, INTERNAL REVENUE SERVICE

Mr. MILLER. Chairman Thomas, Ranking Member Rangel, Members of the Committee, thank you for the opportunity to address the treatment of credit unions under Federal tax law. Our regulatory role in this area depends upon whether the credit union is chartered by the Federal Government or by a State. The Service has virtually no enforcement responsibility with respect to federally chartered credit unions. We have more but still rather limited engagement responsibility with respect to State-chartered credit unions. Credit unions were formed to encourage thrift among members and to create a source of credit at a reasonable rate of interest. Congress has stated that credit unions are exempt from tax because they are member-owned, democratically operated, not-for-profit organizations, generally managed by volunteer boards of directors, and because they have a specified mission of meeting the credit and saving needs of consumers, especially persons of modest means. Let me start my discussion of the tax rules with federally chartered credit unions.

Federal credit unions were first chartered by an act of Congress in 1934 and were exempted from tax in 1937. They are chartered and regulated in their operation by the National Credit Union Administration. Once chartered, they are exempt from Federal income tax under the Federal Credit Union Act and are treated as instrumentalities of the United States under Section 501(c)(1) of the Internal Revenue Code. Federal credit unions are liable for Federal unemployment and Social Security taxes, but are not subject to the tax on unrelated business income, which is the tax imposed on income derived from a trade or business that is not substantially related to the exempt purpose of an entity. Federal credit unions do not file information returns with the IRS, nor do they apply to the IRS for recognition of exemption. Other than employment taxes, we have no oversight over these entities. For State-chartered credit unions, the tax treatment is significantly different. Favored Federal tax treatment for these entities dates from a 1916 statute. The exemption of State-chartered credit unions from Federal income tax is now governed by sections 501(c)(14)(A). State-chartered credit unions are exempt if they are without capital stock, are organized and operated for mutual purposes, without profit and under a State law governing the formation of credit unions.

State-chartered credit unions do not need to file with the IRS for exemption, but some do. In that event, they must show the State and date of their incorporation and that they comply with the State law applicable to loans, investments, and dividends. In addition, 34 States have group rulings in which the State regulatory authority controls additions or deletions to the group and notifies the IRS of the names and addresses of new and departing members. State-chartered credit unions are also required to file an annual information return with the IRS. Like Federal credit unions, State-chartered credit unions are liable for employment taxes; however, unlike the Federal credit unions, they are subject to unrelated business income tax. As part of our overall examination program for tax-exempt organizations, we do examine State-chartered credit unions. We currently have about 50 such examinations underway. We are finding that not only are State-chartered credit unions engaging in traditional core credit union activities, but many are also engaging in a wide range of other activities, including marketing a variety of insurance products. We are working to determine which of the traditional activities are subject to the unrelated business income tax.

Let me conclude. The IRS has begun to rebalance its efforts by placing greater emphasis on enforcement. This applies across the board, including the tax-exempt community. As we proceed in the tax-exempt sector, we have found that some areas have become difficult to administer because industry practice or the industry itself has changed over decades, while the tax rules have remained constant. The transformation of credit unions and other financial institutions is an excellent example of this kind of change, with credit unions offering new services and entering new markets. We take no position on whether credit unions should be taxable or whether the treatment of Federal and State-chartered credit unions should be conformed. What we can say is that, with respect to exemption, the IRS has a very limited role. However, industry changes do raise concerns for the IRS. As State-chartered credit unions offer new services, we have the responsibility of determining which of them generate taxable income. This is a factually intensive and difficult analysis. Thank you, and we look forward to working with you and your staff on these and similar issues.

[The prepared statement of Mr. Miller follows:]

Statement of Steven T. Miller, Commissioner, Tax-Exempt and Government Entities Division, Internal Revenue Service

Background

Mr. Chairman, thank you for the opportunity to address this Committee on the treatment of credit unions under federal tax law. As I will explain, the rules governing this segment of the nonprofit community derive from various federal and state laws, not merely from the Internal Revenue Code. Our regulatory role is dependent upon the nature of the credit union. Credit unions may be chartered by the federal government or by a state. The Service has virtually no enforcement responsibility with respect to federally chartered credit unions. We have more, but still rather limited enforcement responsibility, with respect to state chartered entities.

There is no definition of what constitutes a credit union in the Internal Revenue Code. The IRS looks to the National Credit Union Administration (NCUA), which administers the Federal Credit Union Act, to identify federal credit unions, and to applicable state law to identify state chartered credit unions. Notwithstanding the lack of a uniform definition and the variations in the statutes under which they are created, credit unions do generally share some common characteristics. These include operation on a mutual basis by and for the membership; ownership by the members of the shares on which dividends are paid; officers elected by the membership with each member having one vote regardless of the number of shares held; and the opportunity of members to deposit funds and receive loans from the institution. Nonmembers cannot make deposits with, or receive loans from, credit unions.

Credit unions were formed to encourage thrift among members by holding member funds on deposit, making loans, and creating a source of credit at a fair and reasonable rate of interest in order to improve the economic and social conditions of credit union members.[1]

In general, credit union statutes (including the federal statute) require some sort of common bond among members. This usually is based upon working for a common employer, being employed in a similar occupation, or residing in a specific geographic locale.[2] The common bond is a major factor distinguishing credit unions from other financial institutions such as banks and savings and loan companies, which are open for business with the general public without regard to employment, occupation, or area of residence.

Applicable Legal Framework and Interaction with Internal Revenue Service

History and Standards for Tax Exemption—Federal Credit Unions

The federal credit union charter was created by act of Congress in 1934.[3] Federal credit unions became exempt from tax in 1937.[4] Federal credit unions are exempt from federal income taxes under the Federal Credit Union Act[5] and as a result are described in section 501(c)(1) of the Code, which refers to corporations, organized under an act of Congress, that are instrumentalities of the United States. Federal credit unions are chartered and regulated in operation by NCUA. NCUA determines the standards for qualification as a federal credit union under the Federal Credit Union Act, and determines which applicants qualify for federal credit union status. By operation of law, once NCUA makes this determination, federal law exempts the organization from tax, and the IRS accepts the finding as determinative of whether the organization is an instrumentality of the U.S. Government for purposes of section 501(c)(1).

In recent decades, as a result of deregulation in the industry, the law governing federal credit unions has allowed expansion of the services federal credit unions

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[1] *La Caisse Populaire Ste. Marie (St. Mary's Bank) v. U.S.*, 563 F.2d 505 (1st Cir., 1977), *aff'g* 425 F. Supp. 512 (D. N.H., 1976). See also 31 U.S. Op. Atty. Gen. 176. In Pub.L. 105–219, sec. 2(4), 105th Congress (1998), Congress found that credit unions are exempt from tax "because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and saving needs of consumers, especially persons of modest means."

[2] 12 U.S.C. § 1759 provides that federal credit union membership shall be limited to groups having a common bond of occupation and association, or to groups within a well-defined neighborhood, community, or district. State statutes vary as to the extent of the common bond requirement.

[3] Pub. L. 73–467, 48 Stat. 1216 (1934).

[4] Pub. L. 75–416, 51 Stat. 4 (1937).

[5] 12 U.S.C. § 1768.

offer to their members.[6] At the same time, common bond restrictions have been relaxed to allow a wider membership base.[7]

History and Standards for Tax Exemption—State Credit Unions

State chartered credit unions have existed at least since 1909, and favored federal tax treatment dates from a 1916 statute that conferred exemption on "cooperative banks without capital stock organized and operated for mutual purposes and without profit". (39 Stat. 766). In 1917, an opinion memorandum from the Office of the Attorney General interpreted this phrase to include credit unions.[8] State credit unions were first expressly designated by statute as exempt from tax in the Revenue Act of 1951.

The exemption of state chartered credit unions from federal income tax is governed by section 501(c)(14)(A) of the Internal Revenue Code. State chartered credit unions are exempt if they are without capital stock and are organized and operated for mutual purposes and without profit. The Service's published guidance echoes the statute, adding that an entity also must be organized and operated under a state law governing the formation of credit unions in order to qualify for exemption.[9] In general, state law determines the extent of the common bond required of the membership of a state chartered credit union.[10]

Applicability of Unrelated Business Income Tax

As federal instrumentalities, federal credit unions remain liable for federal unemployment and social security taxes,[11] but they are exempt from unrelated business income tax.[12] State chartered credit unions are liable for employment taxes as well, but have no exemption from unrelated business income tax. The unrelated business income tax is a tax on income derived by a tax exempt entity from a trade or business that is regularly carried on and that is not substantially related to the exercise or performance of the purpose or function constituting the basis for the entity's exemption.[13]

Filing and Reporting Requirements

Federal and state chartered credit unions differ in their respective reporting requirements. Because federal credit unions are described in section 501(c)(1), they do not file information returns with the IRS, nor do they apply to the IRS for recognition of exemption.[14] They are instead responsible to the NCUA for adherence to Federal Credit Union Act requirements.

While optional, state chartered credit unions may file a notice with the IRS to be recognized as exempt, although there is no prescribed format. The IRS accepts a form furnished to applicants by the Credit Union National Association (CUNA) for this purpose.[15] Applicants must show the state and date of incorporation, and that they comply with the state law applicable to loans, investments, and dividends. Thirty-four states hold group rulings, in which a state regulatory authority controls additions and deletions to the group and notifies the IRS of the names and addresses of new and departing members.

State chartered credit unions are required to file annual information returns with the IRS (Forms 990). The IRS received over 1360 individual forms 990 from state chartered credit unions in 2003, the last year for which we have complete filing data. A state regulatory authority with a group exemption ruling may file a group

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[6] Some examples of law changes to permit federal credit unions to expand their services include changes to the Federal Credit Union Act in 1977 (expanded savings, lending, and investment powers); the Monetary Control Act of 1980, P.L. 96–221 (share draft accounts); and the Garn-St. Germain Depository Institutions Act of 1982, P.L. 97–320 (expanded mortgage loan authority).

[7] The Credit Union Membership Access Act of 1998, Pub. L. 105–219, authorized credit unions to have multiple common bonds. The legislation overturned the holding of *National Credit Union Administration v. First National Bnk & Trust Co.*, 522 U.S. 479 (1998).

[8] 31 U.S. Op. Atty. Gen. 176.

[9] Rev. Rul. 69–282, 1969–1 C.B. 155; Rev. Rul. 72–37, 1972 C.B. 152.

[10] For purposes of federal tax law, the IRS is not precluded from challenging whether an organization meets state law common bond requirements or whether such state law requirements are adequate in defining a credit union. But see note 18 below.

[11] IRC § 3308; IRC § 3112.

[12] IRC § 511(a)(2)(A).

[13] IRC § 513(a).

[14] See Treas. Reg. § 1.6033–2(g)(1)(vi); Rev. Rul. 89–94, 1989–2 C.B. 233, relating to information returns. IRC § 508(a) and IRC § 505(c) require designated organizations to apply for exempt status. These provisions do not designate federal or state chartered credit unions. Federal credit unions are subject to an independent application process with NCUA.

[15] Rev. Proc. 56–2, 1956–1 C.B. 1017. State chartered credit unions may apply in order to have reliance on their exempt status with the IRS.

return for all exempt state chartered credit unions under its control and supervision.[16] In 2003, 21 states out of the 34 states holding group rulings filed group Form 990 returns, covering over two thousand organizations.

Examination Issues

Unless employment tax issues are present, the IRS does not examine federal credit unions because generally there are no federal taxation issues to be resolved.[17]

We do examine state chartered credit unions and currently have about 50 examinations underway. These examinations all involve the application of the tax on unrelated business income. The IRS generally accepts the state's recognition that an organization is a credit union and therefore we rarely challenge exemption of such organizations on that basis. An attempt by the IRS to revoke a state chartered credit union's exemption based upon the expansive services it offered to its members and the sufficiency of the common bond of the organization's membership was unsuccessful. *La Caisse Populaire Ste. Marie (St. Mary's Bank) v. U.S.*, 563 F.2d 505 (1st Cir.,1977).[18]

In our examinations, we are finding that state chartered credit unions are engaging in traditional core activities of providing savings facilities and loans to members, as well as offering more recently established services such as home mortgages and credit and debit cards. We are finding that many are also engaging in a wide range of other activities. Among these are:

- The sale of optional credit life insurance and credit disability insurance to members who obtain loans from the organization. If the borrower dies or becomes disabled, the insurance pays off the loan balance.
- The sale of GAP ("Guaranteed Auto Protection") auto insurance. This pays the automobile loan balance in the event of loss or destruction of a vehicle to the extent it exceeds the value of the vehicle.
- The sale of automobile warranties.
- The sale of cancer insurance.
- The sale of accidental death and dismemberment insurance.
- ATM fees charged to non-members.
- The sale of health or dental insurance.
- The marketing of mutual funds to members.
- The marketing of other insurance and financial products.

We are working to determine which of these additional activities have a substantial relationship to the purposes and function of the state credit unions involved, and whether amounts derived from such activities are taxable.[19]

The IRS has asserted that an exempt membership organization engages in an unrelated trade or business when it sells insurance products to its members. The courts have endorsed that interpretation in multiple cases, although no court cases to date specifically involve sales by a section 501(c)(14)(A) credit union to its members.[20]

Conclusion

In prior testimony before this Committee, we have discussed the extensive growth in the tax-exempt sector in recent decades, and the fact that there has been little change in the law governing organizations that qualify for tax-exempt status.

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[16] Rev. Rul. 60–364, 1960–2 C.B. 382.

[17] As with other financial institutions, however, the IRS does monitor Bank Secrecy Act and currency transaction reporting compliance.

[18] The case presented what the IRS believed to be extremely favorable facts for the Government. There was no written common bond and the organization held itself out to the public as a full-service bank. See Action on Decision 1979–41 (May 4, 1978), which indicated that the loss of the case coupled with the expansion of the powers of federal credit unions "cast considerable doubt upon whether the Service will be able to ever successfully challenge the exempt status of credit unions." See also GCM 37467 (1978) for a discussion of the A.O.D. The IRS also considered the sufficiency of a state chartered organization's common bond in GCM 38345 (1980), without adverse action, stating that the IRS should only challenge exemption where there is no common bond, de facto or otherwise.

[19] A technical advice memorandum in 1995 finds income derived from credit life and credit disability insurance to be UBIT. PLR 9548001. A series of three IRS information letters from the early 1970's took the contrary position with respect to credit disability insurance. At this time we have thirty technical advice cases pending involving credit union activities.

[20] *United States v. American Bar Endowment*, 106 S.Ct. 2426 (1986), which involved an organization described in section 501(c)(3); *Louisiana Credit Union League v. United States,* 693 F. 2d 1097 (5th Cir. 1982), a section 501(c)(6) organization; *Professional Insurance Agents of Michigan v. Commissioner*, 726 F.2d 1097 (6th Cir. 1984), also a section 501(c)(6) organization.

One of the four enforcement objectives of the IRS as outlined in the 5-year strategic plan published in 2004, is to deter the abuse and misuse of tax-exempt organizations. As a result, the IRS has begun to rebalance its efforts by increasing enforcement assets and activities directed at the tax-exempt community in general.

As we proceed in this effort, we have found that some areas have become difficult to administer because industry practice, or the industry itself, has changed over the decades, while the tax rules have remained constant. The deregulation and resulting transformation of credit unions and other financial institutions is an excellent example of this kind of change. The credit union industry has evolved into something substantially different from what it was, offering new services and entering new markets.

We take no position on whether credit unions should be taxable or whether the treatment of federal and state chartered credit unions should be conformed. What we can say is that with respect to exemption, the IRS has a very limited role. However, industry changes have raised issues. As the services provided by state chartered credit unions expand, we have the responsibility of determining which of them generate income that is subject to the unrelated business income tax. This is a factually intensive and difficult analysis.

We appreciate the opportunity to provide this Committee with information. We have previously testified in support of a thorough review of the nonprofit sector, and this hearing is a welcome part of that review.

We look forward to working with you and your staff on these and similar issues.

Chairman THOMAS. Thank you, Mr. Miller. Mr. Hillman?

STATEMENT OF RICHARD J. HILLMAN, MANAGING DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENTS, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. HILLMAN. Chairman Thomas, Members of the Committee, I am pleased to be here today to discuss issues regarding the tax-exempt status of credit unions. My prepared statement today includes discussion on: one, the historical basis of the tax-exempt status and arguments for and against taxing these institutions; two, information on the extent to which credit unions offer services that are distinct from those offered by banks of comparable size; and, three, information from prior work assessing available information on the extent to which credit unions are serving low- and moderate-income individuals. The basis for continuing tax-exemption of credit unions, although not often articulated in legislation over the years, appears to be related to the perceived distinctness of credit unions and their service to people of modest means. More specifically, unlike banks, credit unions are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors, and these institutions have a specific mission of meeting credit and savings needs of people of small or modest means.

Arguments for taxing credit unions centered on creating a level playingfield among financial institutions. Recent growth of the credit union industry is often cited as support for the argument that many credit unions now compete more directly with banks. Proponents of taxing credit unions also point to the potential revenue associated with repealing the tax-exemption with the Federal agencies estimating over $1 billion in potential annual revenues. Those in favor of taxation also question the extent to which the tax subsidy provided to credit unions is being used to serve people of modest means, especially in comparison with peer group banks. Opponents of taxation argue that credit unions remain distinct, both organizationally and operationally, from other financial institutions. Opponents also point out that taxation could jeopardize the safety and soundness of credit unions since their net worth or capital levels are restricted to retained earnings only. Opponents also note that other depository institutions do have opportunities for tax relief such as S corporation status.

As part of further addressing this issue, I would like to provide two slides and some contextual information on the size of the credit union industry and its distribution of assets, as well as to provide trend information on the changes in credit union membership. As of December 2004, the Federal Government chartered about 62 percent of the slightly more than 9,000 credit unions. Figure 1, shown on the screens, illustrates institution size and asset distribution in the credit union industry. The top bar reflects that as of December 31, 2004, the 4,255 smallest credit unions, those with $10 million or less in total assets, constituted nearly half of all credit unions, but only 2.5 percent of the industry's total assets. Conversely, the 98 credit unions with assets over $1 billion, which is the shortest bar at the bottom of the figure, held 33 percent of the total industry assets, but represented just 1 percent of all credit unions. In an earlier 2003 report, we noted that as of December 31, 2002, there were just 71 credit unions with assets over $1 billion, and figures through June 2005 indicate that there are now 103 credit unions with over $1 billion in assets. So, the size of credit unions continues to grow. Despite this growth, the credit union industry remains much smaller than the banking industry, with credit unions representing around 6 percent of the total assets of both industries.

As the credit union industry has evolved, the historical distinction between credit unions and other depository institutions has continued to blur. Since 1992, the number of credit unions has declined, but total assets of the industry have grown. The consolidation in numbers and concentration in assets have resulted in two distinct groups of credit unions: a few relatively large credit unions providing a wide range of services that resemble those offered by banks of similar size, and a number of smaller institutions that provide basic financial services. Among the more significant changes that have occurred in the credit union industry over the past two decades have been the weakening or blurring of the common bond that traditionally existed between credit union members. Credit union membership may be based on one of three types of common bond: a single bond, which is typically employer or occupation based; multiple common bonds, which allow for more than one single bond within an institution; and community bonds, which are comprised of persons or organizations within a well-defined local community, neighborhood, or rural district.

The next figure, shown on the screens, provides additional information on the percent of assets of federally chartered credit unions by bond type. While multiple-bond credit unions have constituted on average slightly under 50 percent of all credit unions since 2000, they represented 57 percent of credit union assets. This chart also shows that the percent of community bond credit unions has more than doubled since 2000, growing from 9 percent of federally chartered credit unions in 2000 to 19 percent by the end of 2004. The steepest growth of the assets in federally chartered credit unions also comes from community bonds, which comprise about $92 billion in assets at the end of 2004. In conclusion, the movement toward geographically based fields of membership and other expansion of the common bond restrictions, in conjunction with expanded lines of financial services, have made credit unions more competitive with banks. These changes have raised questions about the extent to which credit unions are fulfilling their perceived historical mission of serving individuals of modest means, yet limited comprehensive data are available on the incomes of credit union members.

In prior work on the credit union industry, our assessment of available data suggested that credit unions served a slightly lower proportion of households with low and moderate incomes than do banks. To the NCUA's credit, it has established a low-income credit union program and an underserved program that are intended to provide increased services to low- and moderate-income individuals and underserved areas. However, NCUA currently does not collect comprehensive data such as the overall income on individuals benefiting from these programs to allow for definitive conclusions about the information on incomes that the membership serves. As a result, we recommended in 2003 to NCUA that it develop more tangible indicators to determine whether credit unions have provided greater access to credit union services in underserved areas. The NCUA has yet to adopt any indicators but says it has established a working group to study credit union success in reaching people of modest means. Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or the other members may have at the appropriate time.

[The prepared statement of Mr. Hillman follows:]

Statement of Richard J. Hillman, Managing Director, Financial Markets and Community Investment, U.S. Government Accountability Office

Mr. Chairman Thomas and Members of the Committee:

I am pleased to be here today to discuss issues regarding the tax-exempt status of credit unions. Credit unions are the only type of financial institution currently exempt from federal income taxes.[1] As we have noted in a prior testimony before this Committee, the size of the tax-exempt sector has grown in recent years in both the number and assets of institutions.[2] Today's hearing on issues related to the credit union tax-exempt sector is timely in light of current and projected fiscal imbalances and renewed emphasis on accountability and governance in both the corporate and nonprofit sectors. A comprehensive examination could help determine whether exempt entities such as credit unions are providing services that are commensurate with their favored tax status, and whether an adequate framework exists for ensuring that these entities are meeting the requirements for tax-exempt status. The information that I am providing today is based primarily on prior work com-

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[1] Qualified financial institutions can elect to avoid federal corporate income tax as Subchapter S corporations (S-corporations). S-corporation tax status mainly allows small, closely held corporations meeting certain requirements to elect to eliminate corporate-level taxation. S-corporation shareholders are taxed on their portion of the corporation's taxable income, regardless of whether they receive a cash distribution. For more information on S-corporations, see GAO, Banking Taxation: Implications of Proposed Revisions Governing S-Corporations on Community Banks, GAO/GGD–00–159 (Washington, D.C.: Jun. 23, 2000).

[2] GAO, Tax-Exempt Sector: Governance, Transparency, and Oversight Are Critical for Maintaining Public Trust, GAO–05–561T (Washington, D.C.: Apr. 20, 2005), and GAO, Nonprofit, For-Profit, and Government Hospitals: Uncompensated Care and Other Community Benefits, GAO–05–743T (Washington, D.C.: May 26, 2005).

pleted on the credit union industry and on ongoing work underway for this Committee.[3]

Based on your request, I will discuss:

- the historical basis for the tax-exempt status of credit unions;
- arguments for and against the taxation of credit unions, including estimates of the potential tax revenues from eliminating the tax-exempt status of credit unions;
- the extent to which credit unions offer services that are distinct from those offered by banks of comparable size;
- the extent to which credit unions are serving low- and moderate-income individuals, including relevant programs of the National Credit Union Administration (NCUA) that target these individuals; and
- the extent to which credit unions are required to report or make public certain information such as executive compensation and assessments of their internal controls for financial reporting.

In summary, we found that:

- The basis for continuing tax exemptions for credit unions, although not often articulated in legislation over the years, appears to be related to the perceived distinctness of credit unions and their service to people of modest means. Congress originally granted tax-exempt status to credit unions in 1937 because of their similarity to other mutually owned financial institutions that were tax exempt at that time. While the other institutions lost their exemption in the Revenue Act of 1951, credit unions specifically retained the exemption. The legislative history on the 1951 act did not articulate a rationale for the continued exemption of credit unions. However, more recent legislation (the Credit Union Membership Access Act of 1998 or CUMAA) states that credit unions are exempt from taxes because "they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors, and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."[4]
- Recently, arguments for taxing credit unions have centered on creating a "level playing field" among financial institutions in terms of taxation, referencing the notable recent growth of the credit union industry to support the idea that credit unions compete more and more directly with banks. Proponents of taxing credit unions also point to the potential revenue associated with repealing the tax exemption. There is also some debate regarding the extent to which credit unions are serving people of modest means, especially in comparison with small banks. In response, opponents of taxation have argued that credit unions remain distinct—both organizationally and operationally—from other financial institutions, and that taxation would jeopardize the safety and soundness of credit unions by adversely impacting their net worth or capital levels, which are restricted to retained earnings. Opponents also note that other depository institutions do have opportunities for tax relief as S-corporations. Federal estimates of the potential tax revenues fall within a somewhat narrow range—$1.2 billion to $1.6 billion annually—while nongovernmental sources have produced higher estimates of up to $3.1 billion annually.
- As the credit union industry has evolved, the historical distinction between credit unions and other depository institutions has continued to blur. The number of credit unions declined between 1992 and 2004, although the total assets of the industry have grown. As of 2004, credit unions with more than $100 million in assets represented about 13 percent of all credit unions and 79 percent of total assets. The consolidation in numbers and concentration of assets has resulted in two distinct groups of credit unions: a few relatively large institutions providing a wide range of services that resemble those offered by banks of the same size, and a number of smaller credit unions that provide basic financial services. For example, the loan portfolios of larger credit unions tend to hold more mortgage and real estate loans, resembling those of similarly sized banks. Smaller credit unions tend to carry smaller loans such as car loans. Ad-

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[3] GAO, Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management, GAO–04–91 (Washington, D.C.: Oct. 27, 2003) and GAO, Credit Unions: Reforms for Ensuring Future Soundness, GAO/GGD–91–85 (Washington, D.C.: Jul. 10, 1991).

[4] See Public Law 105–219 (Aug. 7, 1998), 112 STAT. 914. The Federal Credit Union Act of June 26, 1934 refers to "make more available to people of small means credit for provident purposes." While these statutes have used "small means" and "modest means" to describe the type of people who credit unions might serve, these terms are not defined in the statutes.

ditionally, larger credit unions tend to offer a range of products and services similar to those offered by banks.

- As credit unions have become larger and begun offering a wider variety of services, the issue of whether these institutions are serving households with low and moderate incomes has become a matter for debate. Yet, limited comprehensive data are available on the income of credit union members. In prior work on the credit union industry, our assessment of available data—the Federal Reserve's 2001 Survey of Consumer Finances and other studies—suggested that credit unions served a slightly lower proportion of households with low and moderate incomes than banks.[5] To NCUA's credit, it has established programs that are intended for low-income individuals and underserved areas. However, NCUA does not collect comprehensive data such as the overall income of individuals benefiting from these programs to allow definitive conclusions about the membership served.
- Most credit unions are not specifically subject to reporting requirements that would disclose information on executive compensation or assessments of internal controls for financial reporting—information that can enhance public confidence in tax-exempt entities. Publicly available financial reports reflect, and support, strong governance and transparency—essential elements in assuring that tax-exempt entities operate with integrity and effectiveness and maintain public trust. For example, public disclosure of revenue and expenses, such as the compensation of officers and directors, enhances transparency. However, most credit unions do not individually file the Internal Revenue Service (IRS) form that would provide such information—Form 990, Return of Organization Exempt from Income Tax—because of exclusions and group filings.[6] Further, as we noted in a 2003 report, credit unions with assets over $500 million are not subject to internal control reporting requirements applicable to banks and thrifts under the Federal Deposit Insurance Corporation Improvement Act (FDICIA), which are similar to the reporting requirements of public companies affected by the Sarbanes-Oxley Act of 2002.[7] As we suggested in 2003, making credit unions of $500 million or more subject to the FDICIA internal control reporting requirements would provide a commensurate tool to NCUA and appropriate state regulators to ensure that credit unions establish and maintain internal control structure and procedures for financial reporting purposes.

Background

Credit unions have historically occupied a unique niche among financial institutions. Credit unions differ from other depository institutions because they are (1) not-for-profit entities that build capital by retaining earnings (they do not issue capital stock), (2) member-owned cooperatives run by boards elected by the membership, and (3) tax-exempt. Like banks and thrifts, credit unions have either federal or state charters. Federal charters have been available since 1934, when the Federal Credit Union Act was passed. States have their own chartering requirements. As of December 2004, the federal government chartered about 62 percent of the slightly more than 9,000 credit unions and states chartered the remainder. Both federally and state-chartered credit unions are exempt from federal income taxes, with federally chartered and most state-chartered credit unions also exempt from state income and franchise taxes.

Another distinguishing feature of credit unions is that they may serve only an identifiable group of people with a common bond. More specifically, credit union membership may be based on one of three types of common bond: single, multiple, or community. For example, a group of people that share a single characteristic, such as a common profession, could constitute the "field of membership" for a single-bond credit union. Field of membership is used to describe all the individuals and groups, including organizations, which a credit union is permitted to accept for membership.[8] More than one group having a common bond could constitute the membership of a multiple-bond credit union. And, persons or organizations within a well-defined community, neighborhood, or rural district could form a community-bond credit union. Further, credit unions can offer members additional services

[5] GAO–04–91.

[6] Most tax exempt entities annually must file a Form 990 with the IRS. Form 990 is publicly available and contains various revenue and expense information, including compensation data for officers, directors, trustees, and key employees.

[7] GAO–04–91.

[8] See GAO/GGD–91–85 for additional background on the history of NCUA and state field of membership regulatory policies.

made available by third-party vendors and by certain profit-making entities with which they are associated, referred to as credit union service organizations (CUSO).[9]

Rationale for the Historical Tax Exemption of Credit Unions

The tax-exempt status of credit unions originally was predicated on the similarity of credit unions and mutual financial institutions; however, while Congress did not always cite its reasons for continuing this exemption, recent legislation mentions the cooperative structure and service to persons of modest means as reasons for reaffirming their exempt status.[10] The Revenue Act of 1913 exempted domestic building and loan associations (now called "savings and loans"), and mutual savings banks not having a capital stock represented by shares, from federal income tax.[11] Further, the Revenue Act of 1916 exempted from taxation cooperative banks without capital stock organized and operated for mutual purposes and without profit.[12] However, credit unions were not specifically exempted in either of these acts. Their tax-exempt status was addressed directly for the first time in 1917, when the U.S. Attorney General determined that credit unions closely resembled cooperative (mutual savings) banks and similar institutions that Congress had expressly exempted from taxation in 1913 and 1916.

The Federal Credit Union Act of 1934 authorized the chartering of federal credit unions. The stated purpose of the act was to "establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States." The 1934 act did not specifically exempt federal credit unions from taxation. In 1937, the act was amended to exempt federal credit unions from federal tax and limit state taxation to taxes on real and tangible personal property.[13] Two reasons were given for the exemption: (1) that credit unions are mutual or cooperative organizations operated entirely by and for their members; and (2) that taxing credit unions on their shares, much as banks are taxed on their capital shares, places a disproportionate and excessive burden on the credit unions because credit union shares function as deposits.[14]

The Revenue Act of 1951 amended section 101(4) of the 1939 Internal Revenue Code to repeal the tax-exempt status for cooperative banks, savings and loan societies, and mutual savings banks, but it specifically provided for the tax exemption of state-chartered credit unions.[15] While the act's legislative history contains extensive discussion of the reasons why the tax-exempt status of the other mutual institutions was revoked, it is silent regarding why the tax exempt status of credit unions was not also revoked.

The Senate report accompanying the Revenue Act of 1951 stated that the exemption of mutual savings banks was repealed in order to establish parity between competing financial institutions.[16] According to the Senate report, tax-exempt status gave mutual savings banks the advantage of being able to finance growth out of untaxed retained earnings, while competing corporations (commercial banks) paid tax on income retained by the corporation. The report stated that the exempt status of savings and loans was repealed on the same grounds. Moreover, it stated that savings and loan associations were no longer self-contained mutual organizations, for which membership implied significant investments over time, risk of loss, heavy penalties for cancellation of membership or early withdrawal of shares, and in which members invested in anticipation of becoming borrowers at some time. Instead, investing members were simply becoming depositors who received relatively fixed rates of return on deposits that were protected by large surplus accounts, and

[9] A CUSO is a corporation, limited liability corporation, or limited partnership that provides services such as insurance, securities, or real estate brokerage, primarily to credit unions or members of affiliated credit unions. Credit unions can invest up to 1 percent of their capital in CUSOs. CUSOs must maintain a separate identity from the credit union. See 12 C.F.R. Part 712 (2003).

[10] Internal Revenue Code section 501(c) describes 28 categories of organizations that are exempt from federal income tax. State credit unions are exempt in a category by themselves under section 501(c)(14)(A). Federal credit unions are exempt under section 501(c)(l). Section 501(c)(l) exempts certain corporations that have been organized under an act of Congress, designated as instrumentalities of the United States, and that are exempt from tax by the Internal Revenue Code or by certain congressional acts.

[11] Public Law 63–16.

[12] Public Law 64–271.

[13] Public Law 416.

[14] H.R. Rep. No. 75–1579, at 2 (1937).

[15] Public Law 80–183.

[16] S. Rep. No. 82–781 (1951).

borrowing members dealt with savings and loans in the same way as other mortgage lending institutions.[17]

More recently (in 1998), CUMAA amended the Federal Credit Union Act to, among other things, allow multiple-bond federal credit unions under certain circumstances (such as a general limitation on the size of each member group to 3,000 members).[18] In addition, CUMAA reaffirmed the federal tax exemption of credit unions, despite contentions that allowing multiple-bond credit unions would permit credit unions to become more like banks. Specifically, the findings section of CUMAA stated:

Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.

Arguments for and against Taxation of Credit Unions

At various times, the executive branch has proposed taxing credit unions, generally endorsing the creation of a "level playing field" among financial institutions in which organizations engaged in similar activities would be taxed similarly. Proponents of taxation contend that larger credit unions compete with banks in terms of the services they provide. Proponents also have questioned the extent that credit unions have remained true to their historical mission of providing financial services to persons of modest means. In response, opponents of the taxation of credit unions have argued that credit unions remain distinct organizationally and operationally from other financial institutions, providing their membership with services they would not receive from other institutions. Opponents also have argued that taxation would hinder the ability of credit unions to build capital (which is restricted to retained earnings), jeopardizing their safety and soundness. Finally, opponents have argued that other depository institutions, particularly smaller banks, also have opportunities for tax and regulatory relief such as S-corporation status.[19] Some studies have attempted to quantify potential tax revenue from repealing the tax exemption, with estimates ranging from $1.2 billion to $3.1 billion, depending on the fiscal year considered, tax rates used, and other underlying assumptions.

Arguments for Taxation

Unlike income retained by most other financial institutions, income retained by credit unions is not taxed until it is distributed to members. Thus, tax exemption allows credit unions to utilize untaxed retained earnings to finance expansion of services. Proponents of taxing credit unions claim that this ability to use untaxed retained earnings provides credit unions with a competitive advantage over banks and thrifts. In 1978, the Carter Administration proposed that the tax-exempt status of credit unions be gradually eliminated to mitigate this advantage and establish parity between credit unions and thrift institutions. The Administration also argued that the relaxation of rules regarding field of membership criteria, the expansion of credit union powers, and the rising median income of credit union members indicated that credit unions were no longer true mutual institutions serving low-income workers excluded from banking services elsewhere.

In 1984, the Department of the Treasury (Treasury) report to the President included a proposal to repeal the tax exemption of credit unions, which also argued that the exemption gave credit unions a competitive advantage over other financial institutions and its repeal would "eliminate the incentive for credit unions to retain, rather than distribute, current earnings." In 1985, the Reagan Administration proposed taxing credit unions with more than $5 million in gross assets, but would have maintained the exemption on credit unions with less than $5 million of gross assets, since it was reasoned that taxing small credit unions would significantly increase the administrative burden for a relatively small revenue increase.[20] Similarly, in the budget for fiscal year 1993 the first Bush Administration proposed taxing credit unions with assets of more than $50 million.

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[17] While both banks and thrifts were subject to federal corporate income tax after 1951, some special provisions served to reduce their tax liability relative to corporations in other industries. Over time, Congress scaled back many of these provisions, including special deductions for additions to bad debt reserves.

[18] Public Law No. 105–219.

[19] See GAO, Banking Taxation: Implications of Proposed Revisions Governing S-Corporations on Community Banks, GAO–00–159 (Washington, D.C.: June 2000).

[20] See the President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity, May 1985, 247–248.

More recent arguments for the taxation of credit unions note the strong growth rates among large credit unions, which tend to offer a wider array of services. As a result, taxation proponents argue that larger credit unions compete with banks in terms of the services they provide and the households to which they provide these services. They question both the extent to which credit unions serve people of modest means and pass on their tax subsidy to members. While limited data are available to evaluate the income of credit union members—which precludes any definitive conclusion—some studies, including one of our own, indicate that credit unions serve a slightly lower proportion of households with low and moderate incomes than banks.[21] We discuss this issue in more detail later in this statement.

Arguments against Taxation

Arguments against repealing the tax exemption for credit unions assert that the exemption does not offer competitive advantages and that it is justified by the unique services credit unions offer and by their capital structure. As we reported in 1991, credit unions as organizations are exempt from federal and state income taxes. However, the income that their members receive is taxed. Members who receive dividends on share accounts are taxed on that income, just as depositors at commercial banks are taxed on interest income from savings or checking accounts. If credit unions distribute all income to shareholders and do not retain earnings at the entity level, all income will be taxed at the individual level. In this case, credit unions would have little tax advantage relative to taxable mutual financial institutions, whose income is taxed once at either the individual or entity level.

In 2005 and in previous testimonies, trade and industry groups and private individuals presented arguments supporting the tax-exempt status of credit unions, maintaining that tax-exempt status is justified because credit unions provide unique services, such as small loans, financial counseling, and low-cost checking accounts that for-profit financial institutions are unable or unwilling to provide.[22] They stated that taxing credit unions would lead credit unions away from their mutual, nonprofit orientation and structure, leading to reductions in these types of services. They also testified that taxation would hinder credit unions in building reserves, and since credit unions do not have the ability to raise capital through the sale of stock, their safety and soundness would be jeopardized. They argued that while the number of large credit unions has grown over the last 10 years, they hold a relatively small share of overall depository institution assets. Opponents also argued that there is no clear rationale for targeting larger credit unions because, regardless of asset size, larger credit unions retain a distinct organizational structure and must still adhere to limits on their field of membership as sanctioned by Congress. Furthermore, they argued that larger credit unions, relative to smaller credit unions, were more stable and efficient and therefore better able to offer programs targeted to low- and moderate-income households.

Opponents of credit union taxation also have argued that other financial institutions are not without tax privileges and tax relief. Specifically, credit union trade organizations have pointed out that an increasing number of banks have converted to S-corporation status and, thereby, have avoided paying corporate income taxes. In general, U.S. tax law treats corporations and their investors as separate taxable entities. Corporate earnings are taxed first at the corporate level and again at the shareholder level, as dividends if the corporation distributes earnings to shareholders, or as capital gains from the sale of stock. In contrast, the earnings of S-corporations are taxed only once at the shareholder level, whether or not the income is distributed. Corporations that elect Subchapter S status are subject to certain restrictions on the number of shareholders and capital structure. For example, an S-corporation may not have more than 75 shareholders, all of whom must be U.S. resident individuals (except for certain trusts and estates) and may issue only one class of stock. Prior to 1996, banks and other depository institutions could not elect S-corporation status. A provision of the Small Business Job Protection Act of 1996 repealed this prohibition.

Like credit unions, mutual thrifts are owned by their depositors and their equity is derived from retained earnings. Mutual thrifts are permitted a tax deduction for amounts paid or credited to their depositors as dividends on their accounts if the amounts may be withdrawn on demand (subject only to the customary notice of intention to withdraw). These dividends are taxed only at the depositor level, whether they represent interest or a return on equity, so that mutual thrifts are taxed only

[21] GAO–04–91, p.16.

[22] Representatives of the Credit Union National Association, the National Association of Federal Credit Unions, and the Consumer Federation testified before Congress in 1985 as well as in 2005.

on retained earnings. Further, some farmer's cooperatives are allowed additional tax deductions for dividends on capital stock and distributions to patrons. The earnings of a cooperative generally flow through to the patron and are taxed once at that level. Finally, some other similar entities, like rural electric associations and telephone cooperatives are tax-exempt.[23]

Estimates of the Potential Tax Revenues from Taxing Corporations Vary Widely Based on the Source and Underlying Assumptions

Governmental entities have attempted to estimate the potential revenue to the federal government from repealing the tax exemption that ranged from $1.2 billion to $1.6 billion on an annualized basis. In a 2001 report, the Department of the Treasury estimated potential revenue between $1.2 billion and $1.4 billion annualized over the five year period from 2000–2004, and $1.4 and $1.6 billion over the ten-year period from 2000 to 2009, if all credit unions were taxed. More recently, in Analytical Perspectives, Budget of the United States Government Fiscal Year 2005, Treasury estimated the potential tax revenue from repealing the credit union tax exemption at $7.88 billion from fiscal years 2005 through 2009, or $1.58 billion on average annually.[24] However, according to Treasury officials, the 2005 Analytical Perspectives estimate did not account for any behavioral changes in response to taxation by credit unions in contrast with estimates from their earlier 2001 study. The Joint Committee on Taxation in a February 2005 Congressional Budget Office report estimated that taxing credit unions with assets greater than $10 million dollars would potentially raise $6.5 billion from fiscal years 2006 through 2010, or $1.3 billion on average annually over that five year period.[25]

Nongovernmental entities have produced estimates that tend to be higher than the estimates generated by government agencies. A study issued by the Tax Foundation, which was funded by the Independent Community Bankers of America, estimated the potential revenue from taxing all insured credit unions to be as high as $3.1 billion per year when averaged over the 10-year period from 2004 to 2013.[26] Another private study conducted by Chmura Economics & Analytics for the Jefferson Institute for Public Policy estimated the revenue from taxing all credit unions to be $1.89 billion in 2002, when the same corporate tax rate as banks paid was applied to credit unions (in categories differentiated by asset size).[27] In reviewing these studies, we note that assumptions vary on the tax rates imposed and the response of credit unions to the imposition of taxes (such as distributing higher dividends, lowering loan rates, or increasing deposit rates, which would reduce taxable income and therefore potential tax revenue). However, large credit unions, though small in numbers, are responsible for a disproportionate amount of the potential tax revenue as compared with small credit unions.

Historical Distinctions between Credit Unions and Other Depository Institutions Have Continued to Blur

Since 1992, credit unions have become less distinct from other depository institutions of similar size, particularly in terms of the products and services offered by larger credit unions. Between 1992 and 2004, the total assets held by federally insured credit unions more than doubled, while the total number of federally insured credit unions declined. As a result of the increase in total assets and the decline in the number of federally insured credit unions, the credit union industry has seen an increase in the average size of its institutions and a slight increase in the concentration of assets. Total assets in federally insured credit unions grew from $258 billion in 1992 to $647 billion in 2004, an increase of 150 percent. During this same period the number of federally insured credit unions fell from 12,595 to 9,014. As of the end of 1992, credit unions with more than $100 million in assets represented 4 percent of all credit unions and 52 percent of total assets; as of the end of 2004, credit unions with more than $100 million in assets represented about 13 percent of all credit unions and 79 percent of total assets. From 1992 to 2004, the 50 largest

[23] There are three categories of cooperatives under the Internal Revenue Code: (1) exempt farmers cooperatives, described in section 521; (2) certain mutual or cooperative entities described in section 501(c)(12), which are exempt from taxation pursuant to section 501(a); and (3) taxable cooperatives, governed by subchapter T of the code (sections 1381–1388).

[24] U.S. Department of the Treasury estimates as published in Analytical Perspectives: Budget of the United States Government, Fiscal Year 2005, (Washington, D.C.: 2004).

[25] Joint Committee on Taxation estimates as published in the Congressional Budget Office's Budget Options (Washington, D.C.: February 2005).

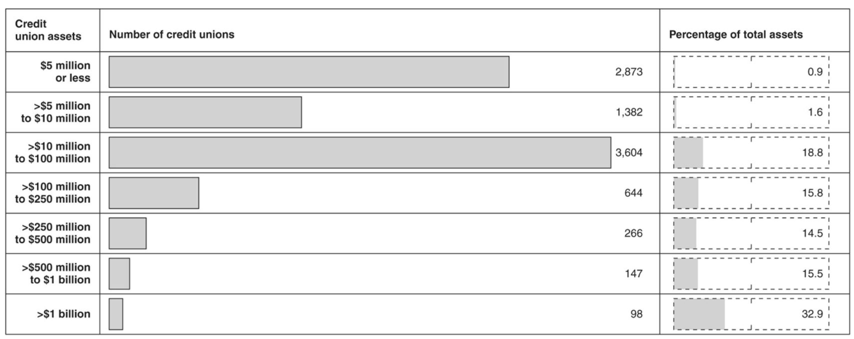
[26] John A. Tatom, Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions (The Tax Foundation: Washington, D.C.: 2005).

[27] Chmura Economics & Analytics, An Assessment of the Competitive Environment Between Credit Unions and Banks (Jefferson Institute for Public Policy: Virginia, May 2004).

credit unions (by asset size) went from holding around 18 percent of industry assets to around 24 percent of industry assets.

This industry consolidation contributed to a widening gap between two distinct groups of federally insured credit unions—larger credit unions, which are relatively few in number and provide a wider range of services, and smaller credit unions, which are greater in number and provide more basic banking services. Figure 1 illustrates institution size and asset distribution in the credit union industry, with institutions classified by asset ranges. As of December 31, 2004, the 2,873 smallest credit unions—those with $5 million or less in total assets—constituted almost one-third of all credit unions but slightly less than one percent of the industry's total assets. Conversely, the 98 credit unions with assets over $1 billion (up to just under $23 billion) held 33 percent of total industry assets but represented just 1 percent of all credit unions. In our 2003 report, we noted that as of December 31, 2002, 71 credit unions with assets over $1 billion held 27 percent of total industry assets.

Figure 1: Credit Union Industry Size and Total Assets Distribution, as of December 31, 2004



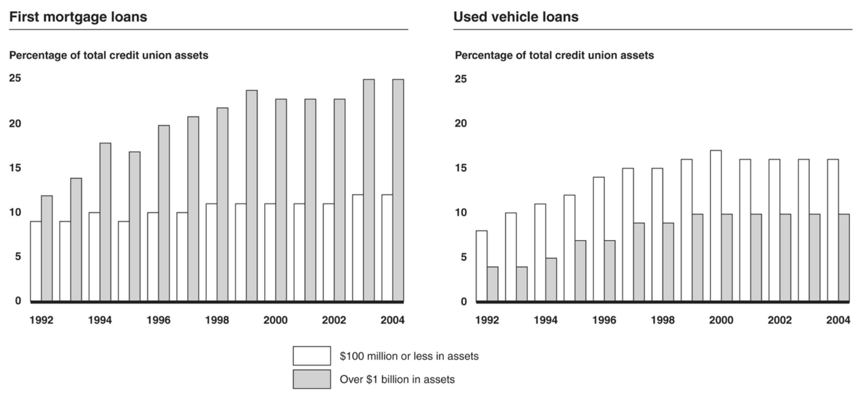
Source: GAO analysis of NCUA Form 5300 data.

Note: This figure depicts credit union industry distribution in terms of the number of federally insured credit unions in a particular asset size category and the percentage of industry assets that are held by credit unions in that category.

As credit unions' assets have grown in recent years, credit unions have generally shifted to larger loans such as mortgages. Between 1992 and 2004, the amount of first mortgage loans held grew from $29 billion to $130 billion, while that of new vehicle loans increased from $29 billion to $71 billion and that of used vehicle loans increased from $17 billion to $85 billion. In terms of the relative importance of different loan types, we compared the growth in the amounts of various loan types relative to credit unions' assets over the same period. Amounts held in first mortgage loans grew from around 11 percent of assets in 1992 to around 20 percent of assets in 2004, while amounts held in used vehicle loans grew from just under 7 percent to slightly more than 13 percent.

As shown in figure 2, larger credit unions generally held relatively larger loans (e.g., first mortgage loans) than smaller credit unions, which generally held relatively more small loans (e.g., used vehicle loans). Since 1992, the amount of first mortgage loans held relative to assets has more than doubled for credit unions with over $1 billion in assets, from around 12 percent to over 25 percent of assets, while it has grown less than 40 percent for credit unions with less than $100 million in assets, from around 9 percent to slightly more than 12 percent of assets.

Figure 2: Loan Types as a Percentage of Total Assets, Smallest verus Largest Credit Unions, 1992–2004



Source: GAO analysis of NCUA Form 5300 data.

The discrepancy between smaller and larger credit unions is more apparent through an analysis of more recently collected data on more sophisticated product and service offerings, such as the availability of automatic teller machines (ATM) and electronic banking (see table 1). While less than half of the smallest credit unions offered ATMs and one-third offered transactional websites, nearly all larger credit unions offered these services.

Table 1: Credit Union Size and Offerings of More Sophisticated Services, as of December 31, 2004

Percentage of institutions offering the following services

							Website		
Asset range	Number	Group assets (billions)	Financial Services through the Internet	Financial services through audio response or phone	ATMs	Electronic applications for new loans	Informational	Interactive	Transactional
$10 million or less	7,859	$138	37.8	44.3	47.0	25.3	16.0	4.0	32.9
Greater than $100 millions to $250 million	644	$102	94.7	97.4	95.0	82.1	3.7	2.2	92.2
Greater than $250 to $500 million	266	$94	98.5	98.5	96.6	89.8	0.8	1.5	97.0
Greater than $500 million to $1 billion	147	$100	98.0	98.0	98.0	92.5	2.0	1.4	95.9
Greater than $1 billion	98	$213	98.0	98.0	98.0	95.9	1.0	2.0	96.9
Total	9,014	$647	51.2	51.2	53.3	33.1	14.3	3.7	40.7

Source: GAO analysis of NCUA Form 5300 data.
Note: Data are based on all federally insured credit unions filing call reports.

Despite the growth in credit union assets over recent years, the credit union industry remains much smaller than the banking industry, with credit unions representing around 6 percent of total assets of both industries.[28] For example, at the end of 2004, the largest credit union had nearly $23 billion in assets, while the largest bank, with $967 billion in assets, was larger than the entire credit union industry combined.

Although credit unions are on average much smaller than banks, larger credit unions and banks of comparable size tend to offer the same products and services (see fig. 3).[29] In particular, nearly all banks and larger credit unions reported holding first mortgage loans, while a majority of the smaller credit unions did not.

Figure 3: Percentage of Credit Unions and Banks Holding Various Loans, by Institution Size, as of December 31, 2004

Institution assets range		Number	Assets (dollars in billions)	Percentage of institutions with the loan type: First mortgage	Junior mortgage and home equity	Credit card	Other consumer	Agricultural and business
$100 million or less	Credit unions	7,859	$138	46.5%	56.6%	45.4%	99.8%	13.1%
	Banks	3,604	186	96.3	74.8	14.1	97.4	96.2
Greater than $100 million, but less than or equal to $250 million	Credit unions	644	102	97.4	97.8	85.1	100.0	48.1
	Banks	2,169	343	98.7	95.1	30.3	98.9	97.9
Greater than $250 million, but less than or equal to $500 million	Credit unions	266	94	98.9	98.5	86.1	100.0	62.8
	Banks	973	343	98.3	97.0	36.6	98.3	97.8
Greater than $500 million, but less than or equal to $1 billion	Credit unions	147	101	99.3	98.6	90.5	100.0	66.7
	Banks	467	323	97.9	96.8	34.7	97.9	97.2
Greater than $1 billion	Credit unions	98	213	100.0	100.0	92.9	100.0	79.6
	Banks	426	1,549	96.7	95.1	39.9	97.2	96.5
Total	Credit unions	9,014	647	53.1	62.0	50.7	99.9	18.7
	Banks	7,639	2,744	97.4	85.9	24.3	97.9	97.0

Credit unions
Banks

Source: GAO analysis of NCUA and FDIC call report data.

Notes: Data are based on all federally insured credit unions, banks, and thrifts filing call reports. We excluded insured U.S. branches of foreign-chartered institutions and banks that we determined had emphases in credit card or mortgage loans. Credit union data on other consumer loans may include member business and agricultural loans. Agricultural and business loans for credit unions include both member business loans and participation in nonmember loans.

The Extent to Which Credit Unions Serve Persons of Modest Means Is Not Definitively Known because of Limited Data and Lack of Indicators

While credit union fields of membership have expanded, the extent to which they serve people or communities of low or moderate incomes is not definitively known. In 1998, CUMAA affirmed preexisting NCUA policies that had allowed credit unions to expand their field of membership and include underserved areas.[30] After the legislation was passed, NCUA revised its regulations to enable credit unions to serve

[28] Credit union assets grew from $438 billion at year-end 2000 to $647 billion at year-end 2004—an increase of 48 percent—while banking industry assets grew from $7.5 trillion at year-end 2000 to $10.1 trillion at year-end 2004—an increase of 35 percent. Credit unions represented 6.0 percent of the combined assets of the banking and credit union industries as of December 31, 2004, versus 5.6 percent as of December 31, 2000.

[29] Given the disproportionate size of the banking industry relative to the credit union industry—the average credit union had $72 million in assets versus $1.1 billion in assets for the average bank at year-end 2004—we developed peer groups by asset size to mitigate the effects of this discrepancy. We constructed five peer groups in terms of institution size as measured by total assets, reported as of December 31, 2004. We further refined the sample of FDIC-insured institutions to exclude those banks and thrifts we determined had emphases in credit card or mortgage loans. The largest bank included in our analyses had total assets of nearly $23 billion at year-end 2004, and the average bank in this peer group sample had $359 million in assets.

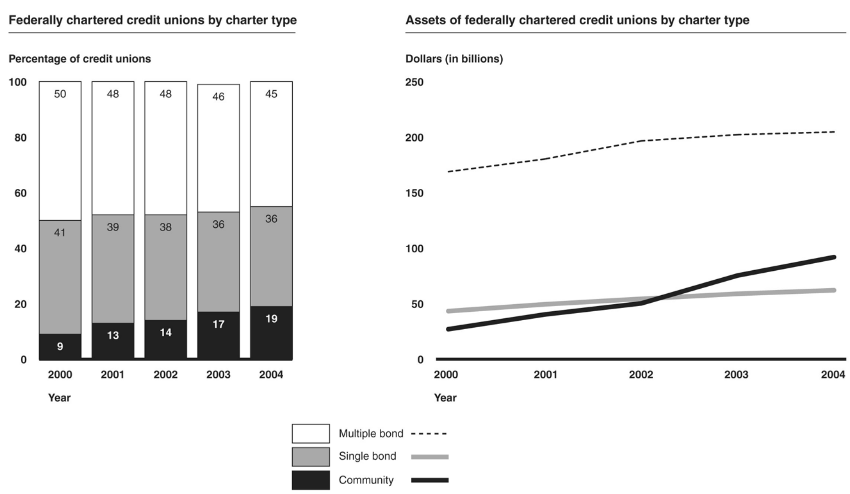
[30] The Federal Credit Union Act defines an "underserved area" as a local community, neighborhood, or rural district that is an "investment area" as defined by the Community Development Banking and Financial Institutions Act of 1994. An investment area includes locations experiencing poverty, low income, or unemployment.

larger communities or geographic areas. As they have become larger and begun offering a wider variety of services, questions have been raised about whether credit unions are more likely than banks to serve households with low and moderate incomes. However, limited comprehensive data are available to evaluate the income of credit union members. Our assessment of available data—the Federal Reserve's 2001 Survey of Consumer Finances (SCF) and other studies—provided some indication that, compared with banks, credit unions served a slightly lower proportion of households with low and moderate incomes. Although NCUA has undertaken initiatives to enhance the availability of financial services to individuals of modest means, as of October 15, 2005, it had not implemented our 2003 recommendation to develop indicators to evaluate the progress credit unions made in reaching the underserved.

Credit Unions Can Serve More People and Larger Areas because CUMAA Permitted NCUA to Continue Preexisting Policies That Expanded Field of Membership

In 1998, the Supreme Court ruled against NCUA's practice of permitting federally chartered credit unions based on multiple bonds.[31] Subsequently, Congress passed CUMAA, which specifically permits multiple-bond credit unions. The act permits these credit unions to retain their current membership and authorizes their future formation.[32] Figure 4 provides additional information on the percent and assets of federally chartered credit unions by bond type. While multiple-bond credit unions have constituted on average slightly under 50 percent of all credit unions since 2000, they tend to be larger than the other two types of credit union bonds in terms of asset size.[33] For example, at year-end 2004, multiple bond credit unions made up 45 percent of the total number of federal credit unions but represented 57 percent of federal credit union assets.

Figure 4: Percent and Assets of Federally Chartered Credit Unions, by Bond, 2000–2004



Source: NCUA.

Note: NCUA provided revised data for the year 2000 from that previously provided for our 2003 report.

In addition to permitting multiple-bond credit unions, CUMAA further qualifies the definition of community bond. The act adds the word "local" to the preexisting requirement that community-based credit unions serve a "well-defined community, neighborhood or rural district," but provides no guidance on how "local" or any other

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[31] National Credit Union Administration v. First National Bank & Trust Company. 522 U.S. 479 (1998).

[32] See 12 U.S.C. § 1759(b), (d), as amended.

[33] With the exception of the statistics provided for multiple-bond credit unions for 1996, NCUA cannot provide us data on federal chartering trends before 2000. However, NCUA was able to report that by 1996, about half of all federally chartered credit unions were multiple-bond credit unions.

part of this requirement should be defined.[34] However, after the passage of CUMAA, NCUA revised its regulations to make it easier for credit unions to serve increasingly larger areas (e.g., entire cities or counties). As a result, NCUA approved a community-based charter application in July 2005 covering Los Angeles County with a potential membership of 9.6 million.

Limited Comprehensive Data Are Available to Evaluate Income of Credit Union Members

While it has been generally accepted that credit unions historically have emphasized service to people with modest means; currently, there are no comprehensive data on the income characteristics of credit union members, particularly those who actually receive loans and other services. Industry groups and consumer advocates have debated which economic groups benefit from credit union services, especially in light of the credit unions' exemption from federal income taxes. As stated in our 1991 report, and still true, none of the common-bond criteria available to federally chartered credit unions refer to the economic status of their members or potential members.

Information on the extent to which credit unions are lending and providing services to households with various incomes is scarce because NCUA, industry trade groups, and most states (with the exception of Massachusetts and Connecticut) have not collected specific information describing the income of credit union members who obtain loans or benefit from other credit union services.[35] Credit unions—even those serving geographic areas—are not subject to the federal Community Reinvestment Act (CRA), which requires banking regulators to examine and rate banks and thrifts on lending and service to low- and moderate-income neighborhoods in their assessment area.[36] Consequently, NCUA and most state regulators do not require credit unions to maintain data on the extent to which loans and other services are being provided to households with various incomes.

Federal Reserve Board Data Suggest That Credit Unions Serve a Slightly Lower Proportion of Low- and Moderate-Income Households Than Do Banks

Our prior work, which included an analysis of data from the Federal Reserve Board's 2001 SCF, suggested that credit unions overall served a lower percentage of households of modest means (low- and moderate-income households combined) than banks.[37] More specifically, while credit unions served a slightly higher percentage of moderate-income households than banks, they served a much lower percentage of low-income households. We combined the SCF data into two main groups—households that primarily and only used credit unions versus households that primarily and only used banks.[38] As shown in figure 5, this analysis indicated that about 36 percent of households that primarily and only used credit unions had low or moderate incomes, compared to 42 percent of households that used banks. Moreover, our analysis suggested that a greater percentage of households that primarily and only used credit unions were in the middle and upper income grouping than the proportion of households that primarily and only used banks.

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[34] Pub. L. No. 105–219 § 101. See 12 U.S.C. § 1759(c)(2), as amended.

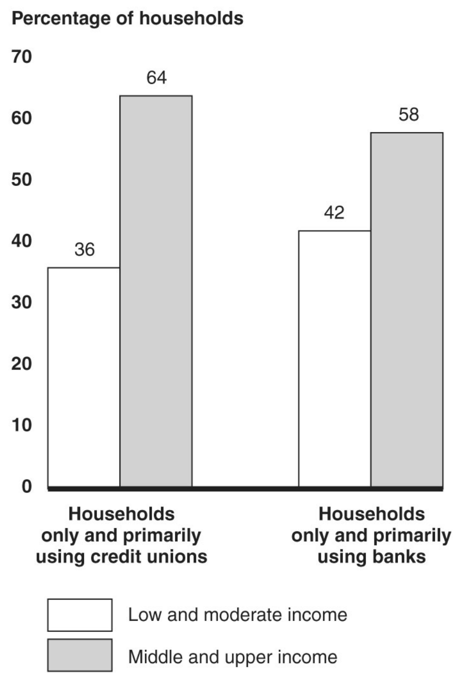
[35] The Credit Union National Association, a trade association, collects information about the characteristics (for example, income, race, and age) of credit union members but not specifically the income levels of members who actually receive mortgage and consumer loans or use other services. Also, Massachusetts and Connecticut collect information on the distribution of credit union lending by household income and the availability of services because their state-chartered credit unions are subject to examinations similar to those of federally regulated institutions. Massachusetts established its examination procedures in 1982 and Connecticut in 2001.

[36] CRA requires federal bank and thrift regulators to encourage depository institutions under their jurisdiction to help meet the credit needs of the local communities, including low- and moderate-income areas, in which they are chartered, consistent with safe and sound operations. See 12 U.S.C. ϕϕ 2901, 2903, and 2906 (2000). Federal bank and thrift regulators conduct CRA examinations to evaluate the services that depository institutions provide to low- and moderate-income neighborhoods. However, CRA provides for enforcement only when regulators evaluate an institution's application for a merger or new branch, requiring that the agencies take an institution's record of meeting the credit needs of its community into account.

[37] The SCF is an interview survey of U.S. households conducted by the Federal Reserve Board that includes questions about household income and specifically asks whether households use credit unions or banks. It is conducted every 3 years and is intended to provide detailed information on the balance sheet, pension, income, and other demographic characteristics of U.S. households, and their use of financial institutions.

[38] See GAO–04–91, pages 19–23, for a more detailed discussion of our analysis and limitations of the SCF data.

Figure 5: Income Characteristics of Households Using Credit Unions versus Banks, and Low and Moderate Income versus Middle and High Income

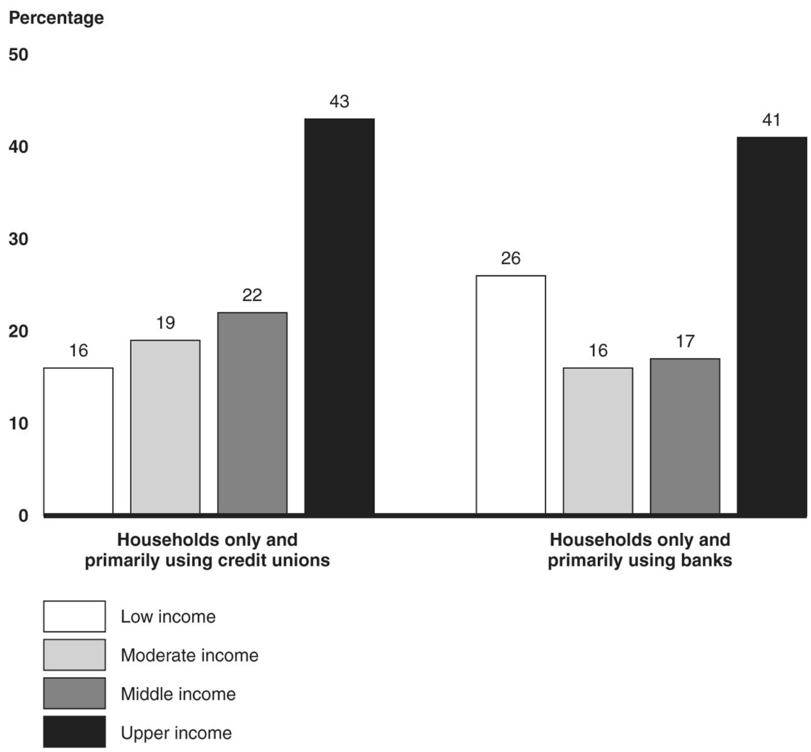


Source: 2001 SCF.

Note: We used the same income categories as used by federal regulators in their CRA examinations.

We also looked at each of the four income categories separately. As shown in figure 6, this analysis suggested that the percentage of households in the low-income category that used credit unions only and primarily (16 percent) was lower than the percentage of these households that used banks (26 percent). In contrast, more moderate- and middle-income households were likely to use credit unions only and primarily (41 percent) than banks (33 percent). Given that credit union membership traditionally has been tied to occupational- or employer-based fields of membership, that higher percentages of moderate- and middle-income households using credit unions is not surprising.

Figure 6: Income Characteristics of Households Using Credit Unions versus Banks, by Four Income Categories



Source: 2001 SCF.

Note: We found no statistical difference in the percent of upper-income households when the "primarily and only" using credit union group and the "primarily and only" using bank group were compared.

We also attempted to further explore the income distribution of credit unions members by separately analyzing households that only used credit unions or banks from those that primarily used credit unions or banks. However, the results were ambiguous and difficult to interpret, due to the characteristics of the households in the SCF database. For example, because such a high percent of the U.S. population only uses banks (62 percent), the data obtained from the SCF is particularly useful for describing characteristics of bank users but much less precise for describing smaller population groups, such as those that only used credit unions (8 percent).

Other relatively recent studies—notably, by the Credit Union National Association and the Woodstock Institute—generally concluded that credit unions served a somewhat higher-income population. The studies also noted that the higher income levels could be due to the full-time employment status of credit union members.[39] Officials from NCUA and the Federal Reserve Board also noted that credit union members were likely to have higher incomes than nonmembers because credit unions are occupationally based. A National Federation of Community Development Credit Unions representative noted that because credit union membership is largely based on employment, relatively few credit unions are located in low-income commu-

[39] Credit Union National Association 2002 National Member Survey and Woodstock Institute, Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low Income People (February 2002).

nities.[40] However, without additional research, especially on the extent to which credit unions with a community base serve all their potential members, it is difficult to know whether the relative importance of full-time employment is the primary explanatory factor.

NCUA Has Established Initiatives That Target Low-Income Individuals and Underserved Areas

NCUA recently has established two initiatives to further enhance the availability of financial services to individuals of modest means: the low-income credit union program and expansion into underserved areas. According to NCUA, its Low Income Credit Unions (LICU) program is designed to assist credit unions whose members are of modest means in obtaining technical and financial services. LICUs grew in number from more than 600 in 2000 to nearly 1,000 by the end of 2004. To obtain a low-income designation from NCUA, an existing credit union must establish that a majority of its members meet the low-income definition.[41] According to NCUA, credit unions that meet this criterion are presumed to be serving predominantly low-income members. Also, newly chartered credit unions can receive low-income designation based on the income characteristics of potential members.

Credit unions that receive a low-income designation from NCUA are measured against the same standards of safety and soundness as other credit unions. However, NCUA grants benefits that other credit unions do not have, including:

- greater authority to accept deposits from nonmembers such as voluntary health and welfare organizations;
- ccess to low-interest loans, deposits, and technical assistance through participation in NCUA's Community Development Revolving Loan Fund;
- ability to offer uninsured secondary capital accounts and include these accounts in the credit union's net worth for the purposes of meeting its regulatory capital requirements;[42] and
- a waiver of the aggregate loan limit for member business loans.

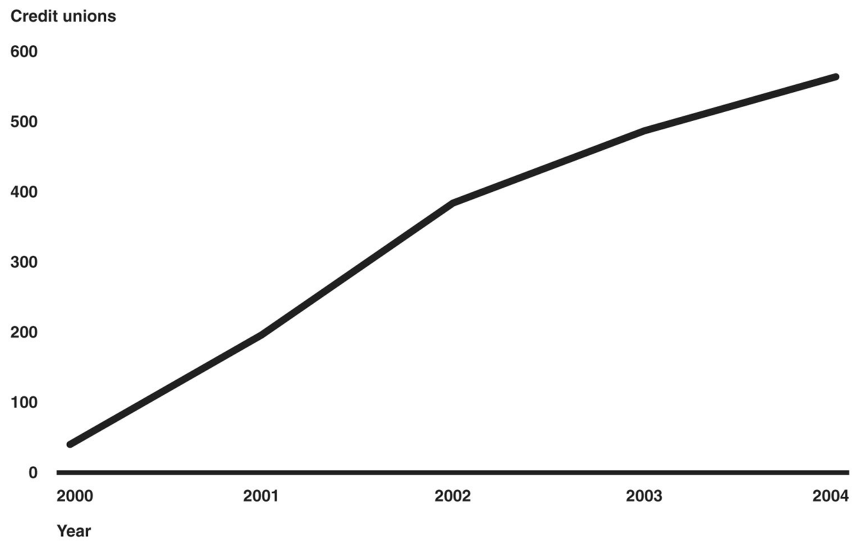
NCUA has stated that one of its goals is to encourage the expansion of membership and make quality credit union services available to all eligible persons. It has done so in part by allowing credit unions to expand into underserved areas in recent years, from 40 in 2000 to 564 in 2004 (see fig. 7).

[40] The National Federation of Community Development Credit Unions represents and provides, among other things, financial, technical assistance, and human resources to about 215 community development credit unions for the purpose of reaching low-income consumers.

[41] Section 701.34 of NCUA's Rules and Regulations defines the term "low-income members" as those members who (1) make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or (2) whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau. The term "low-income members" also includes members who are full—or part-time students in a college, university, high school, or vocational school.

[42] A "secondary capital instrument" is either unsecured debt or debt that has a lower priority than that of another debt on the same asset. These subordinated debt instruments are not backed or guaranteed by the federal share insurance fund.

Figure 7: Credit Union Expansions into Underserved Areas, 2000—2004



Source: NCUA.

CUMAA and NCUA's Interpretive Ruling and Policy Statement (IRPS) 03–1, the Chartering and Field of Membership Manual, allows credit unions to include in their fields of membership, without regard to location, communities in underserved areas. The Federal Credit Union Act defines an underserved area as a local community, neighborhood, or rural district that is an "investment area" as defined by the Community Development Banking and Financial Institutions Act of 1994—that is, experiencing poverty, low income, or unemployment.[43] In order to expand into an underserved area, credit unions must receive approval from NCUA by demonstrating that a community qualifies as an investment area. Credit unions must also provide a business plan describing how the underserved community will be served. Finally, although the underserved and LICU initiatives are intended to help serve the underserved, NCUA does not collect data such as overall income levels of individuals using specific credit union products.

NCUA Has Not Fully Implemented Our Recommendation to Develop Indicators to Evaluate Credit Union Progress in Reaching the Underserved

Although NCUA has targeted underserved individuals and areas, in our 2003 report on credit unions we found that NCUA had data on potential—but not actual—membership of low- and moderate-income individuals in underserved areas adopted by credit unions. We recommended that NCUA use tangible indicators, other than potential membership, to determine whether credit unions have provided greater access to credit union services in underserved areas.[44]

As of October 15, 2005, NCUA had not adopted any indicators. According to NCUA, it has established a working group to study credit union success in reaching people of modest means. NCUA indicated that the working group was exploring meaningful measures of success for this objective, determining how to best quantify the measures with available or readily obtainable data. The working group has also been evaluating the impact of other regulations, such as the Privacy of Consumer Financial Information, on the collection and use of such data. According to NCUA officials, as of October 15, 2005, the working group had not issued its report or recommendations.

[43] Quoted from NCUA Chartering and Field Membership Manual, March 2003, p.3–4 & 3–5
[44] GAO–04–91, p. 83.

Credit Unions Lack Transparency on Executive Compensation and Larger Credit Unions Do Not Have to Report on Effectiveness of Internal Controls

Most credit unions are not subject to IRS and other federal reporting requirements that would disclose information such as executive compensation and assessments of internal controls for financial reporting—information that can enhance public confidence in tax-exempt entities. Public availability of key financial information (that is, transparency) can provide incentives for ethical and effective operations as well as support oversight of the tax-exempt entities. At the same time, the disclosure of such information helps to achieve and maintain public trust.

Recognizing the importance of transparency for tax-exempt entities, Congress made returns of the IRS Form 990 (Return of Organizations Exempt from Income Tax) into publicly available documents. Since tax exemptions are granted to entities so that they can carry out particular missions or activities that Congress judges to be of special value, the public availability of Form 990 promotes public oversight. Most tax-exempt organizations, other than private foundations with gross receipts of $25,000 or more, are required to file Form 990 annually. The form contains information on an organization's income, expenditures, and "activities" including compensation information for officers, directors, trustees, and key employees. IRS also uses these forms to select organizations for examination.

However, most credit unions do not individually file Form 990. In 2002 and 2003, credit unions filed 1,435 and 1,389 Form 990s, respectively. On August 23, 1988, IRS issued a determination that annually filing Form 990 was not required for federal credit unions because of their status as tax-exempt organizations under section 501(c)(1) of the Internal Revenue Code. Depending on the state, some state-chartered credit unions file through a group filing process. For these states, IRS receives only the names and addresses of individual credit unions. As a result, scrutiny of the compensation of credit union executives and other key personnel is difficult. As you are aware, we have ongoing work in this and other areas, and we hope to provide you with additional information on the compensation of credit union executives and officials as part of this follow-up work.

As noted in our 2003 report, the Federal Credit Union Act, as amended, requires credit unions with assets over $500 million to obtain an annual independent audit of financial statements by an independent certified public accountant. But, unlike banks and thrifts, these credit unions are not required to report on the effectiveness of their internal controls for financial reporting. Under FDICIA and its implementing regulations, banks and thrifts with assets over $500 million are required to prepare an annual management report that contains:

- a statement of management's responsibility for preparing the institution's annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with designated laws and regulations relating to safety and soundness; and
- management's assessment of the effectiveness of the institution's internal control structure and procedures for financial reporting as of the end of the fiscal year and the institution's compliance with the designated safety and soundness laws and regulations during the fiscal year.[45]

Additionally, the institution's independent accountants are required to attest to management's assertions concerning the effectiveness of the institution's internal control structure and procedures for financial reporting. The institution's management report and the accountant's attestation report must be filed with the institution's primary federal regulator and any appropriate state depository institution supervisor, and must be available for public inspection.

The reports, with their assessments and attestations on internal controls, allow depository institution regulators to gain increased assurance about the reliability of financial reporting. Also as we stated in our 2003 report, the extension of the internal control reporting requirement to credit unions with assets over $500 million could provide NCUA with an additional tool to assess the reliability of internal controls over financial reporting.

Moreover, bank and thrift reporting requirements under FDICIA are similar to the public company reporting requirements in the Sarbanes-Oxley Act of 2002. Under Sarbanes-Oxley, public companies are required to establish and maintain adequate internal control structures and procedures for financial reporting; the company's auditor is also required to attest to, and report on, the assessment made by company management on the effectiveness of internal controls. As a result of FDICIA and the Sarbanes-Oxley Act, reports on management's assessment of the

[45] 12 U.S.C. § 1831m; 12 C.F.R. Part 363 (2003).

effectiveness of internal controls over financial reporting and the independent auditor's attestation on management's assessment have become normal business practice for financial institutions and businesses.

In a letter dated October 2003, NCUA's Chairman stated that while the Sarbanes-Oxley Act does not apply specifically to federal credit unions, certain provisions may be appropriate to consider for some federal credit unions. Federal credit unions are encouraged (but not required) to consider the guidance provided and are urged to periodically review their policies and procedures as they relate to matters of corporate governance and auditing.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the committee may have.

Chairman THOMAS. Thank you very much, and to determine whether or not there are any Members who wish to inquire, the Chair's inquiry will be withheld until the end of the Members' responses. The Chair would recognize the gentleman from Florida, Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. Ms. Johnson, in your testimony you gave us a good overview as to the structure of member-owned—as to credit unions. Do the members receive complete financial statements from the credit unions such as they would in a corporation?

Ms. JOHNSON. Members receive monthly statements, just like——

Mr. SHAW. Now, I am not talking about their own account. I am talking about——

Ms. JOHNSON. There is an annual report and the regular statements on a monthly basis. The monthly financials are posted monthly.

Mr. SHAW. All right. That is of the overall structure itself?

Ms. JOHNSON. Correct.

Mr. SHAW. This would be reported to them. Do they get—do accountants come in and do—CPAs come in and do opinion reports on them?

Ms. JOHNSON. They have their regularly scheduled audit, opinion audits. The examining from the regulator is done on a regularly scheduled basis, typically either annually or up to 18 months. But, yes, they are required to have audits on a regular basis.

Mr. SHAW. Does that information include salaries paid by the credit union to the officers of the corporation, of the credit union?

Ms. JOHNSON. We do not collect salary information specifically. It has not been required. Federal credit unions are not required to fill out the 990Ts, and so that information is not gathered individually.

Mr. SHAW. Can the individual members get that information? What I am trying to do is establish ownership rights here. Can the individual get that information if they request it?

Ms. JOHNSON. The credit unions are managed by a volunteer board, and the salaries, and so forth, are set by that volunteer board, and the audit and supervisor Committee and the board of directors take care of that part of the management. It is set by the volunteers who are elected by the members of the credit union.

Mr. SHAW. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. Does the gentleman from New York wish to inquire?

Mr. RANGEL. Thank you. Mr. Hillman, with your Government Accountability investigation, could you share with us whether the for-profit banks—what salaries they pay to the executives and employees?

Mr. HILLMAN. We have not gathered information on the banking industry as part of this review, but all publicly owned companies are required through SEC filings to provide information on salaries of key officers and directors.

Mr. RANGEL. Ms. Johnson, do you know whether or not your salaries are competitive or in line with the salaries that are paid in similar institutions that operated for profit?

Ms. JOHNSON. As I said, we don't collect individual salary information. The only bit of information I could give you, on a recent website of one of the firms that is working on behalf of those that are looking perhaps to convert from a credit union to a bank charter, they do have on their website, according to their information, that credit union CEOs are paid approximately 57 percent less than their counterparts.

Mr. RANGEL. Well, throughout your testimony, it seems as though you were advocating a position that credit unions should not be taxed. Are there any reasons politically that you believe that there is any consideration about doing that? If so, what is it?

Ms. JOHNSON. Congressman, the rhetoric is around all the time, I guess. I know when I served as Chairman of the Senate Ways and Means Committee back in Iowa, the rhetoric was happening back then as well. I believe the questions that are asked today about the validity of the tax-exemption are very—they are necessary. I did the same thing in my role back home. But I would tell you that when you are looking to see whether you are getting your money's worth for this tax-exemption, I would assure you that you are getting a lot of bang for the buck. If you set the stage a little bit with the bank versus credit union stature as it is, it is important to note that credit unions only comprise about 6 percent of the industry, of the assets.

Mr. RANGEL. Yes, but what I am getting to is that Mr. Miller would agree that even though the IRS does not have a policy, that the Secretary of the Treasury has publicly stated that he is opposed to taxing credit unions. The President of the United States and the leader of the free world has indicated that he opposes taxing of tax-exempt. So, who would you think represents the concept that would threaten you politically?

Ms. JOHNSON. Only the competition that would like to see competition go away.

Mr. RANGEL. So, you do not feel that threat coming from the Congress or this Committee.

Ms. JOHNSON. I have never had it expressed by a Member of Congress, no.

Mr. RANGEL. You have not?

Ms. JOHNSON. Not directly.

[Laughter.]

Chairman THOMAS. Does the gentleman yield back the time?

Mr. RANGEL. Yes, I do, Mr. Chairman.

Chairman THOMAS. Does the gentlewoman from Connecticut wish to inquire?

Mrs. JOHNSON. Thank you. Mr. Miller, in your testimony you say that credit unions are not required to file the IRS forms that most other tax-exempt entities are required to file, and I would like you to enlarge on that. Then I would like you to enlarge on your claim that credit unions are not subject to internal control reporting requirements that are applicable to banks and thrifts.

Mr. MILLER. Well, Congresswoman Johnson, as to the first item on the filing requirements, again, we need to divide our world between the federally chartered and the State-chartered entities. The federally chartered entities, by reason of being an instrumentality of the U.S. Government, do not have to file Forms 990 with the Service, like any other instrumentality. The States do have to file with us. Now, we received in, I think, 2003 something in excess of 1,360 Forms 990 from some States. We also receive because we have a process that allows for the filing of a group consolidated return, from 21 States we receive consolidated returns, and that contained aggregate information on another 2,000 entities. So, we do have, you know, something in the range of 3,500 or something in the range—of entities that file with us, 2,000 of those are filing on a consolidated basis. I do not, unfortunately, have an answer for you on the internal controls, but perhaps my colleague from the Accountability Office could help out.

Mrs. JOHNSON. Mr. Hillman?

Mr. HILLMAN. Yes, the Federal Deposit Insurance Corporation Improvement Act requires banks and thrifts with assets over $500 million to prepared an annual management report that contains a statement of managers' responsibilities for preparing the institution's annual financial statements, and for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Management assessments are also required on the effectiveness of the institution's internal control structures and procedures for financial reporting. Indeed, internal auditors and external reviewers are required to attest to management's assertion of their internal control standards. As it relates to credit unions, they currently are not required to provide for those management assertions or for their external auditors to provide for independent attestations of the effectiveness and quality of the internal control structures. In a report that we provided to the NCUA and to the Congress, we recommended that the NCUA consider requiring their entities to have external reviews of their internal control structures. Indeed, we recommended to the Congress that they amend the Federal Deposit Insurance Corporation Improvement Act to cause such things to occur. That action is currently under consideration within the Congress.

Mrs. JOHNSON. Without that, what kinds of abuses are possible?

Mr. HILLMAN. Having a properly structured internal control function was very important in considering recent legislation in the Sarbanes-Oxley Act for public companies, for example, financial statements were being prepared that were not accurately reflecting the financial position of the entities, and management was basically indicating that they had no knowledge of the extent to which those numbers were accurate or correct or could be held to any scrutiny. The Sarbanes-Oxley Act was intended to provide managers with an affirmative responsibility to know what their internal control structures were and to know that the financial information that they are providing to the public was accurate. Indeed, doing something of that nature for credit unions is something that would make good public policy as well.

Ms. JOHNSON. I understand that Sarbanes-Oxley provisions, however, have been bearable for larger banks, but they are very expensive and would be very heavy for small independent institutions. Does your recommendation accommodate to that?

Mr. HILLMAN. You are absolutely right. There is continuous debate going on today about the extent to which entities and at what size ought to be providing for these internal control assessments. The current limit is organizations with $500 million in assets and above. They are looking at raising that level to address some burden issues with smaller organizations, and that is a debate also taking place in Congress today.

Mrs. JOHNSON. Thank you.

Chairman THOMAS. The gentleman from California, Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman. Mr. Miller, please recognize the limitation of my understanding of the technical differences between (c)(1)s up through (c)(50)s or (20)s or whatever come under your purview. But based on the underlying initial reason for granting the tax-exemption, could you give us a little insight? I am just going to go down some that come to my mind, and you will probably know a lot more, but irrigation districts, municipally owned electric companies, USAA, a reciprocal insurer, agricultural co-ops, rural electric co-ops, on down the line. In their genesis, was there any great difference in these types of organizations and the (c)(1)s that I guess are credit unions?

Mr. MILLER. Well, again, Mr. Stark, the (c)(1)s are only the federally chartered credit unions.

Mr. STARK. I understand that, but I am just——

Mr. MILLER. In terms of the cooperative nature of the endeavor, they are all a little different.

Mr. STARK. But would you say they are all similar in the reason they hold a tax-exemption or are tax free, from a lay person's——

Mr. MILLER. I would say they are similar, that the rural electric cooperatives obviously are another group of entities that started up because there was no electricity in certain areas of the country. Agricultural co-ops started up because of a need for that business as well, so——

Mr. STARK. But would it be also safe to say, however long ago many of these things started, that the initial reason for their beginnings no longer holds true? I think that former members of the armed services can buy their auto insurance from GEICO or Allstate or anybody they want, and it is a question of whether they pay more or less for it. But it may have been difficult—when my Ranking Member got out of the service, it may have been a different time than it is for those of us who are younger veterans.

[Laughter.]

Mr. STARK. I am just trying to see if in our thinking, as we review this—I do not think it has been stated, but the banks are out to get credit unions taxed because it will make it more difficult for them to compete. I would presume then that my Pacific Gas and

Electric would like to see the rural electric co-ops taxed because then they would have a better competitive edge. But is there any reason for us, outside of the very technical differences, to think about credit unions as distinct from all these other groups, health, education services. There are, I guess, providers of medical care that come under the cooperative rubric. Any reason we should sort those out, or can we think of them as one group?

Mr. MILLER. Well, I would hesitate to put them all in one group, Congressman, because I do think they are different industries and they should be looked at separately.

Mr. STARK. For tax policy, how should we look at them differently?

Mr. MILLER. Tax policy you may be correct, they may be very similar. But, again, if the underlying discussion here is let's take a look to see where the industry is today, then in terms of the Internal Revenue Service's view, that is a useful thing because, as I have mentioned in my testimony, industries change, the laws remain the same, and sometimes that creates difficulties for us in administration.

Mr. STARK. I will come back at you with tax policy. I think what I heard you say is that within all of these, the underlying tx policy is probably the same or very similar.

Mr. MILLER. I think it is going to depend on the particular provision and the particular code provision. And, again, I cannot say in a general fashion that they are all the same, Congressman.

Mr. STARK. One more try. Between (c)(1) and (c)(13), are the tax-exempt rules pretty similar, no unrelated business, I mean——

Mr. MILLER. Not really.

Mr. STARK. Not really, okay.

Mr. MILLER. It really depends. Along the edges they are different. You know, the (c)(12)s, the rural co-ops, the rural electric and rural telephone cooperatives have some very different rules than do Federal credit unions. They go in and out of status on an annual basis, depending on their income sources. They are similar to credit unions in one fashion; that is, they have expanded from their original list of public sector. So, the rules do vary depending on the provision.

Mr. STARK. Thank you.

Chairman THOMAS. Would the gentleman yield briefly?

Mr. STARK. Sure, I would be glad to yield.

Chairman THOMAS. On that point, one of the things, I think—sometimes Members go more deeply into these areas than others. One of the things that I will ask you on my time, but since it was brought up, I want you to think about, is the argument that the (c)(1)s are instrumentalities of the United States in which you then dismiss looking at them because of that categorization as opposed to a 501(c)(3), which is a charitable organization, which allows you based upon what particular category they are in, your ability to do certain things or not do certain things. So, when you say that you do not do this or you do not do that, it is because of the structure as an instrumentality, not that it should or should not be done based upon trying to understand what is going on in an organization. That is something that I think needs to be discussed, and we will look at that a little bit later. But the gentleman is right. When you looked at (c)(1)s, (c)(3)s, on through the various (c)s, it is based upon what they are, which then indicates the relationship between those organizations, notwithstanding the fact they are within the 501 section, and the IRS and the responsibilities associated with the IRS in overseeing those particular structures. Sometimes it just happens to be the category that they are in that they, therefore, do not receive scrutiny and, therefore, cannot get answers to questions that Members would ask. They do not file 990s, so you do not know certain things about them. Why? Because they are instrumentalities of the United States. It begins to get circular in terms of trying to get an answer should we, not do you, and the "should we" is what we should at some point pursue. The gentleman from California, Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. Mr. Miller, if you could tell us just as historical background, generally the history of the tax-exempt sector, Congress usually provided exemption to certain entities because they were providing a service that the government could not provide. In the case of credit unions, could you tell us what social good or public benefit do they provide in exchange for the exemption?

Mr. MILLER. Congressman, I think it is certainly true with respect to many provisions in the exempt sector that there is an underlying rationale of public good in providing general benefit to the community at large. A little more murky with respect to credit unions. They were based on a cooperative structure, and the early legislative history talks about a cooperative enterprise which is offering opportunities for savings, opportunities for credit to those who otherwise might not have it who have joined as members. That is sort of the underlying rationale in the credit union area.

Mr. HERGER. Would either of the other two of our witnesses care to comment? Ms. Johnson?

Ms. JOHNSON. Yes, Congressman, I would like to speak to the public good because I think that is the big question here. Are you receiving the public good in exchange for the exemption? I can very strongly say that the 84.5 million members of the federally insured credit unions benefit from higher rates on their deposits. They benefit from lower fees. They benefit from lower interest on the loans that they take out as members. There was a study done in April of this year by the University of North Carolina in Chapel Hill that estimated that the members of credit unions in North Carolina save an average of $130 a year, and if you were to multiple that nationwide, that could be an eventual savings in the $11 billion category just for the members of the credit unions.

But I would not stop there. There are actually benefits to those that use the services of other financial institutions as well. This limited competition that is in the marketplace helps offer competitive rates for everyone. In fact, there was a statement by a CEO of a large bank earlier this year after their record profits were reported. He said that they would have been higher had it not been for the credit unions because they had to pay higher interest on their deposits. So, it is estimated that saving the customers of other institutions may be as high as $4 billion. I know the estimate has been given that there may be a billion, $1.2, $1.3 billion that could be realized in tax revenue if credit unions were taxed, but I would offer that is far offset by the amount that is saved by the consumer simply by having a minimal competition in the marketplace. Credit union members do pay taxes at the ordinary income level on the dividends they receive, just like bank customers pay taxes on the interest they receive. The exemption really results in a return to the local economy in far excess of what would be realized by any tax revenue, I believe.

Mr. HERGER. Thank you.

Chairman THOMAS. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. Thank you, Mr. Chairman. I think truth may be somewhat relative in this area, so let me just ask Mr. Hillman, because you have presented a number of charts, and it might be useful for us to try to put these figures in a broader perspective. I think there has been—at least we have seen this where I come from—very substantial consolidation in financial services. Indeed, most of the banks that we once knew are now part of larger entities. So, if you look at Figure 1, for example, in terms of industry size and total assets distribution, do you have data, useful data, that tell what has happened to financial services more broadly? For example, if you had a chart like this for financial institutions other than credit unions, what do you think that chart would show?

Mr. HILLMAN. Congressman, it would show probably different numbers but pretty much the same pictures in terms of bars. What you are seeing in the banking sector today is a much more—larger groups of organizations that are much more competitive and much more complex.

Mr. LEVIN. Also I take it—you say the bars would be the same, but in terms of assets, I would think you might see a different picture in terms of the size of the assets, would you not? I mean, you would have to have a somewhat different chart than is here.

Mr. HILLMAN. In order of magnitude, absolutely.

Mr. LEVIN. For example, there may be one, there may be more financial institutions that have more assets than all of the credit unions combined.

Mr. HILLMAN. Yes, that would be true. The largest banking institution has vastly far more assets than the industry as a whole.

Mr. LEVIN. Do you think you could supply us that?

Mr. HILLMAN. Absolutely.

Mr. LEVIN. If you would, go through the charts and just see—there is some information here as to the types of loans, but where you can—and I do not want you to do endless basic research, but if you can, go through your charts one by one and supply us with the picture in these regards as to the entire financial services area. Because I do think—the chairman, for example, did point out a few instances, and I do not mean to minimize them or mimic them, but I do think rather than trying to pick out one or two or three or a few examples, we really need to look at the total picture as it relates to financial services as to who is served, as to the kind of competition, as to who does what. You cannot simply take one area without relationship to what is going on generally in the world.

For example, it would be interesting to know what has happened to smaller financial service entities other than credit unions. I mean, you have a fairly large number in Chart 1 of credit unions with assets $10 million to $100 million, and that is, roughly speaking, as I gather—I did some math—what, about 40 percent—I do not know exactly. Maybe a third of them are in that size category. It would be interesting to know what it is like with other financial institutions to really get some kind of a feel as to who is doing what where.

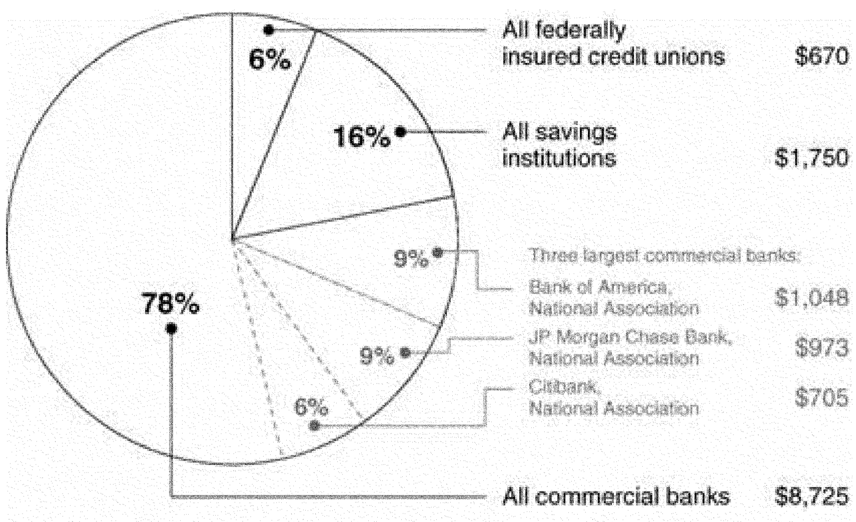
Mr. HILLMAN. As part of our analysis of the credit union industry, we did run comparisons of credit unions at these various sizes and assets to banks of—peer group banks of comparable size. In our prepared statement that we submitted for this hearing, on Figure 3 we provide a variety of information about the types of products and services that credit unions of that size provided, that peer group banks of similar size provided. In addition, in our report in November 2003, we provide a variety of other graphics, which does provide information comparing credit unions to banks as it relates to products and service and as it relates to other forms of activities.

Mr. LEVIN. Okay. So, if you would put this together in as succinct a form as possible, will you?

Mr. HILLMAN. It would be my pleasure.

[The information follows:]

Figure 9: Assets (in billions) of Financial Institutions as of June 30, 2005



Sources: NCUA and FDIC.

Mr. LEVIN. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. The Chair would say that would be very useful, but in beginning to examine the area, I think you will find that it just runs away from you very quickly. With banks, one of the key attractions was the fact that you could write a check. We created share drafts with credit unions, which are, in essence, a check. But as we saw through the eighties and the nineties, more and more structures like stock brokers, you can write what amounts to a check. So, when you say financial institutions, it is not just banks. A lot of the studies I have seen solely use a credit union or solely use a bank. There are very few people, I think, that are in that category of solely doing this or solely doing that. So, I agree with the gentleman. I think we should begin to see that kind of data. But when you say financial institutions, you may have to define it in a way that encompasses all of the various current structures, just as what money has changed, what the financial institution and services provided from them have changed.

Mr. HILLMAN. As well as my initial response to Congressman Levin in dealing with the consolidation in the financial services industry as a whole, there is also a significant convergence within the financial services industry where individual organizations are providing like products and like services, and the competition is becoming fierce.

Chairman THOMAS. Which was not the case in 1937 or 1934 during the Depression.

Mr. HILLMAN. That is correct. Exactly right.

Chairman THOMAS. Does the gentleman from Louisiana wish to inquire?

Mr. MCCRERY. Mr. Hillman, can you explain why Congress revoked the tax-exempt status of mutual insurance companies, mutual savings banks, and mutual savings and loan associations?

Mr. HILLMAN. Mutual savings banks, cooperative banks, and savings and loan associations were originally tax-exempt. In the Revenue Act 1951, before this Committee, Congress removed their tax-exempt status. Committee reports that we reviewed accompanying the legislation indicate that the mutual savings banks were in competition with taxable financial institutions, and the taxation, it was determined, would level the playingfield with their competitors. Similarly, Congress found that savings and loans were no longer self-contained cooperative institutions, and there was little difference between the savings and loans and other financial institutions, and for that reason they chose to provide them with taxation.

Mr. MCCRERY. Is there a similarity today between some credit unions and their competitive position vis-a-vis other financial institutions and what Congress found with mutual savings associations and so forth in 1951?

Mr. HILLMAN. Well, certainly with an increasing—the expansive membership, you are beginning to see blurring lines of distinction between credit unions and entities such as these, which have a tax-exempt status.

Mr. MCCRERY. What about in terms of services offered?

Mr. HILLMAN. Services offered typically by at least the largest credit unions tend to mirror those services offered by peer group banks. There are, as shown, though, in our first slide, almost half of the industry being made up of smaller credit unions, and those credit unions continue to provide more basic services.

Mr. MCCRERY. In your research as to the rationale for revoking the tax-exempt status of those other entities, was there any discussion of the relative sizes of those institutions, any consideration given to revoking or modifying the tax-exempt status based on size?

Mr. HILLMAN. I am not familiar with any indication that that was a consideration, but I would be happy to take a second look and provide that information for the record.

Mr. MCCRERY. Thank you.

[The information follows:]

Our review of the legislative history of the Revenue Act of 1951, in particular Senate Report 82–781, did not identify any documented discussion of institution size as a factor or consideration in the revocation of the tax-exempt status of mutual savings banks and savings and loan associations.

Mrs. JOHNSON. Would the gentleman yield?

Mr. MCCRERY. Sure.

Mrs. JOHNSON. Mr. Hillman, the 50-mile limit that mutual banks have to live with, is that more or less restrictive than the geographic limits on credit union—than the membership limits on credit unions, would you say?

Mr. HILLMAN. The 1998 act added a term "local" to define the boundaries within which a geographically based community credit union could offer services. That act, though, did not provide any further delineation of what was meant by that term "local." So, determination of geographic boundaries or community-based credit unions have been left up to the interpretation of the NCUA. Those credit union decisions in some instances have exceeded a 50-mile radius.

Mrs. JOHNSON. But isn't there a 50-mile radius that governs mutual banks?

Mr. HILLMAN. I am not familiar with that. I would like to do some research and provide that.

[The information follows:]

Federal savings associations (including mutual savings banks) historically evolved as local home-financing institutions, and limitations reflecting this evolution were initially incorporated in the governing statutes. At one point in time, the Home Owners' Loan Act referred to "local" home-financing institutions and the act generally limited real estate lending by Federal savings associations to property that was within fifty miles of their home offices. In 1964, the lending area was expanded to property within one-hundred miles of the home office. In 1970, the restriction was expanded to include property within the state in which the home office was located or within one-hundred miles of the home office. In the eighties, Congress began to remove the geographic restrictions on the lending authority of Federal thrifts. Title IV of the Depository Institutions Deregulation and Monetary Control Act 1980 deleted the geographic restrictions on lending authority by federal savings and loan associations.

Mr. MCCRERY. Just in the time that I have left, would either of the other two panelists like to comment on my initial question and the question of competitiveness and whether that should play a role in our examination of tax-exempt status?

Ms. JOHNSON. I would, Congressman. The initial tax-exemption was granted on the structure of the institution itself. The structure of credit unions has not changed. It is still that cooperative, that not-for-profit institution. There is nothing in the statute concerning the size of the institution, the products or services offered. If one would want to paint the credit unions back into the corner where they were in 1934 when they were first started for the working population, you would be limiting to those of modest means to very modest services. It has been necessary over the years—consumers, credit union members demand the same types of services that other financial institutions provide, and to not provide those services to those who need them most I believe is the wrong direction. I would also say that banks and credit unions have both changed over the years, there is no question, because both are serving their customers, are serving their members in the best way they can. But I would also mention that it was the credit unions that were doing the consumer lending in the thirties, and that is now an area where banks are doing more consumer lending as well. So, there has been a blending going both directions. There is nothing wrong with that, in my opinion. I think providing the best services for your members or for your customers is what every institution strives to do.

Mr. MCCRERY. Thank you.

Chairman THOMAS. I thank the gentleman. The gentleman from Maryland will be the final questioner prior to the Committee recessing for a few minutes to run over and vote.

Mr. CARDIN. Let me thank you and let me thank all of you for your testimony. I strongly believe in a competitive market for financial services, and I was just going to ask a question of Ms. Johnson, and you can respond or respond for the record. You have already touched upon this. The Consumer Federation of America found that the benefits that the credit unions deliver to the public far exceed the costs in the report that they did, and they cited interest rates, higher interest rates, lower service costs for the niche in which they perform their services within the financial community. You have touched upon that in some of your replies. I am wondering whether you can quantitate that more definitively as to the benefits that credit unions are providing versus the value of the tax-exempt status that they enjoy.

Ms. JOHNSON. The statistics that I pointed to are from some individual studies such as the North Carolina study, and there are other studies out there. I have no doubt that the benefits far outweigh what the tax-exemption would bring in.

Mr. CARDIN. If you could make those studies available for our Committee, I am sure we could get them.

Ms. JOHNSON. I would be glad to do that.

Mr. CARDIN. Any other information you have that quantitates that would be useful for us.

Ms. JOHNSON. Thank you. I would be glad to do that.

[The information is being retained in the Committee files.]

Mr. CARDIN. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. The Committee stands in recess, probably until noon.

[Recess.]

Chairman THOMAS. If I could ask our guests to find seats quickly? Does the gentleman from Georgia, Mr. Lewis, wish to inquire?

Mr. LEWIS OF GEORGIA. Thank you very much, Mr. Chairman. Mr. Chairman, I would like to try to solicit a little more information from members of the panel. I think when my colleagues raised the question earlier about what is the redeeming social value of credit unions, I think maybe Mr. Miller or maybe someone said when it comes to tax-exemption for credit unions, maybe it is a little murky. Ms. Johnson, maybe you could tell the Committee, what is the real redeeming social value of credit unions? Is there a greater need today than 40 or 50 or 60 years ago?

Ms. JOHNSON. I would be pleased to address this topic because I think it is probably the heart of the whole issue. The redeeming social value of credit unions is that they provide an option for affordable financial services in the marketplace. There are many folks today that continue to be un-banked, and credit unions have a special mission of reaching those of modest means, and that is an opportunity for them to reach out. You know, as credit unions were initially formed, they were made up of employee groups. That means people that have jobs and that are working. So, most credit unions were actually formed by working people. In the last few years, in particular, credit unions have begun to take on underserved areas, and we have low-income designated credit unions now. We have some that have gone to community charters, which is now allowing them to reach out into the community and reach some of those folks that aren't necessarily the member of an employee group but that are now eligible for membership. There are many in the community that have to rely on predatory lenders, either check-cashing, payday lenders, others that charge much higher fees than credit unions. Credit unions are the only financial institutions that are actually held to a statutory interest rate level, a usury rate. Credit unions cannot charge more than 18 percent. Find me a payday lender that charges less than 18 percent. It just doesn't exist.

Credit unions, I think the mission is even greater today than what it has been in the past, and though they have made great strides over the last few years by being able to reach out in the community, I would admit there is more to be done. I believe, especially in this day and age, when in this economy—in particular, I look at two of our largest credit unions, our military credit unions. Two of the three largest credit unions serve the military population. You show me a group of people that are of more modest means than what our military personnel are, and with these credit unions being able to offer financial services at an affordable rate, I think it is one of the best things that we can do for our military in particular at this time. So, I think the social mission is still very much intact. It is something that the credit unions take very seriously and continue to look for ways that they can fulfill that mission.

Mr. LEWIS OF GEORGIA. Thank you, Ms. Johnson. Mr. Miller? Mr. Hillman?

Mr. MILLER. Mr. Lewis, the only thing——

Mr. LEWIS OF GEORGIA. To be clear for me, was it you who said that the tax-exemption for credit unions may be a little—or did Mr. Hillman—may be a little murky? What do you mean?

Mr. MILLER. It was in response to the question as to what the public benefit is of these organizations.

Mr. LEWIS OF GEORGIA. But what do you see as a public benefit? What do you see as a redeeming social value of credit unions?

Mr. MILLER. I can only speak to what the legislative history talks about in the thirties, and that is that it is a cooperative-based opportunity for people to save and to get credit. That is, I think, the underlying premise.

Mr. LEWIS OF GEORGIA. You would not care to elaborate and say how you really feel?

[Laughter.]

Mr. LEWIS OF GEORGIA. You are going to stick to the letter of the law. You are not going to——

Mr. MILLER. I think, Mr. Lewis, that that is my job here, is to stick to the letter of the law.

Mr. LEWIS OF GEORGIA. I appreciate that. Mr. Hillman?

Mr. HILLMAN. Well, the Federal Credit Union Act 1934 refers to making credit available to people of small means as one of the primary impetuses behind the establishment of credit unions. More recently, the Credit Union Membership Access Act 1998 refers to serving the productive and provident credit needs for individuals of modest means. While these terms are used to describe the types of people who credit unions might serve, these terms are not well defined in the statutes. The NCUA has defined "modest means" or "small means," to us, anyhow, as meaning individuals who are wage earners or who must work in order to make a living, individuals such as these who can provide a benefit from a credit union's services.

Mr. LEWIS OF GEORGIA. Thank you. Mr. Chairman, I yield back my time.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Michigan, Mr. Camp, wish to inquire?

Mr. CAMP. Mr. Chairman, thank you very much. Ms. Johnson, the GAO report talked about credit unions not having the same reporting requirements as other financial institutions, and my question to you is if you could comment on that statement, and then if you could also elaborate how the GAO report said the so-called lack of transparency makes it difficult to evaluate the effect credit unions might have on average Americans. Could you just elaborate on what the tax-exempt status of a credit union does for average Americans?

Ms. JOHNSON. Okay. You had kind of two parts, in responding to the GAO and also the second——

Mr. CAMP. It is a two-part question, how the lack of transparency—if you could comment on that statement in the GAO report, I would like to get your opinion of that.

Ms. JOHNSON. Okay.

Mr. CAMP. The so-called lack of transparency. Then just in general, what benefits for average Americans does the tax-exempt status of credit unions have.

Ms. JOHNSON. Okay. Two good questions. Thank you. In response to the question about the GAO report and the lack of transparency, back in 1998 Congress debated very thoroughly the suggestion or the idea of whether CRA requirements should be required of credit unions. At that time it was reaffirmed that there did not appear—that there was no need to put CRA requirements on. In our work with GAO, the question has arisen about transparency and the opportunity or the ability to really put in hard numbers what credit unions are doing. I would suggest that credit unions are basically CRA in action. They are taking deposits and using those deposits to make loans to other members that need loans. They can only serve their members, and that is the only way the credit union will grow and survive, is to serve those members. It is very difficult—and we have struggled with this—whether some type of a hard reporting is necessary. I look to the nursing home in my hometown who, because of the burdensome regulatory requirements had to take a full-time nurse off the nursing floor in order to just do the paperwork. That is the danger that we run with the credit unions, especially when almost half of our credit unions are less than $10 million in assets.

The reporting requirements, if we are not careful, could heavily outweigh any benefits from the actual reporting itself. You are taking away from the time and the resources, in particular, serving the people that you are supposed to be serving. We do have a Committee working to see if we could arrive at something that would not put the burden on the credit union. Is there some additional data that we could collect on the 5300 report? But, again, it has never been put forth by Congress that a CRA-type report is needed, and at this time I would have to agree with that. Credit unions, we believe, are serving the very members who they are supposed to serve. Let's see. What was the last? On the lack of transparency, it is kind of—is it in regard to this type of reporting?

Mr. CAMP. Well, I was interested in what are some of the filings that you do do as an institution. Certainly there are audits, and you mentioned earlier in your testimony about posting online. What are some of the filing requirements that you do fulfill?

Ms. JOHNSON. The credit unions file their 5300 reports quarterly. The credit unions themselves do CPA audits every year. They have an annual audit and supervisory Committee report that is also done, as I said, annually. I am not exactly sure what type of information you or other Members of Congress would see as the most beneficial of what type of information you are trying to glean that you think would be the most beneficial.

Mr. CAMP. Well, I just wanted to point out for the Committee that there are public filings that credit unions do engage in, and so I appreciate your going through some of those, and that they are filed with regulators of both banking and credit union—both parts of the financial industry. So, thank you very much. Thank you, Mr. Chairman.

Chairman THOMAS. Thank you. Does the gentleman from Pennsylvania wish to inquire?

Mr. ENGLISH. Thank you, Mr. Chairman. I do indeed. Chairman Johnson, does the NCUA measure in what capacity credit unions are serving people specifically of modest means, and if not, can you offer an explanation of whether this would be an administratively feasible task to take on, and in your opinion, would such measures be helpful to Congress in making policy decisions, as well as to consumers?

Ms. JOHNSON. Well, we know credit unions are serving members of modest means by the very fact that they are serving their

Members. We do have some—and I am trying to find my figures here. I have too many pieces of paper. They were some of the stats that Chairman Thomas had actually alluded to earlier. We know those that use only credit unions have lower incomes and lower median wealth than those who use only banks, and I would agree that many of us use both types of institutions. Back home there is not a credit union that I am eligible to join, and so back home I also—I will put in a pitch for my local banker. But we know that credit unions are serving those Members, and we know that those balances, the wealth is lower, so to speak, the wealth of those members is lower. We also know that the member business lending done by credit unions, the average member business loan is much lower than that of someone attaining a business loan or a commercial loan from a bank. The average member business loan for a credit union member is $155,000. That is much lower, that is the average.

Mr. ENGLISH. How exactly do we know that? What is the source and reliability of those figures?

Ms. JOHNSON. That information comes in on our 5300 reports, which are issued on a quarterly basis.

Mr. ENGLISH. Very good. Commissioner Miller, credit unions have, since their inception, had a mission of targeting low- and moderate-income families, and this continues today through programs like the Low-Income Credit Union program and the Underserved Areas program. I, for myself, know from experience in my district that credit unions serve people of moderate means, and I think do a good job. It seems to me though that we still do not have access to many statistics that show the impact of credit unions on low- and moderate-income families on a nationwide basis, and I just had that exchange with Commissioner Johnson. I wonder, in your opinion, what policies could Congress implement to either better track credit union service to families of moderate means and to help us shape policies that would encourage those sorts of opportunities?

Mr. MILLER. Well, Congressman, again, we have talked about it, and we do have to divide our world into the Federal charter versus State charter. As to tax issues, you know, we are the tax agency, and in general, while our Forms 990 have as one of their purposes transparency, that the public can see what these organizations are doing, ultimately they are tax forms. With respect to Federal credit unions we have no tax issues. It would be purely for other purposes that we were making people file this. With respect to State chartered, they do file Forms 990 with us. The Form 9nineties, I do not believe, at this point probably has a meaningful impact on your inquiry here, to be frank.

Mr. ENGLISH. In that case, may I shift, while I have time? Mr. Hillman, same question. What policies could Congress implement to better track precisely who is being serviced by credit unions, whether that service is disproportionately, as the mission indicates, to families of moderate or modest means, and help us shape policies?

Mr. HILLMAN. We have raised this question with the National Credit Union Administration, and they have developed a working group to study this issue, and we encourage them to develop more tangible indicators that would provide information on who credit union members are actually serving. When you look at how credit unions serve individuals, you look at the products and services that individuals might be procuring from credit unions. Those might be individuals who might be procuring loans of some sorts or another. In order to make credit decisions on those loans, there is likely to be information available within their files in order to determine the income levels of those individuals, and I would suggest that that would be one source that could be explored as possibly obtaining some information on the extent to which credit unions do serve individuals of modest means. Second, you could perhaps also come up with a mechanism to provide for a sampling, a stratified sample that cuts across the population of individuals that credit unions are serving, and indeed obtain credible, accurate information on the membership base that credit unions serve. It is not something that is an impossible thing to do.

Mr. ENGLISH. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The gentleman from Washington wish to inquire?

Mr. MCDERMOTT. Thank you, Mr. Chairman. Since I know the President and the Secretary of Treasury have said that they are not interested in taxing the credit unions, the question has to arise, why are we having this hearing? I know all the bankers are in town, and so I believe it is a revenue question. It is a revenue question. It could be raising revenue for a variety of sources, but it seems to me that there is all kinds of evidence that this issue is not something that is pressing anybody. I really believe that the reason we are here having this hearing is because the government is financially and morally broke. Now, the DeLay Congress is one that has enacted a tax cut every year in the face of budget deficits in times of war. Now they are starting to look under rocks for revenue, and you folks are a rock.

Last week this Committee took some revenue out of the hides of foster children living in low-income families. Last week we found revenue by reducing child support enforcement funding by $20 billion. Other Committees have found money by reducing food stamps. The Education and Work force Committee has reduced the availability of student loans to low-income students. That is the way the Republicans view sacrifice in a time of war, and budget problems go after the vulnerable. They sacrifice morality for tax cuts. The DeLay Congress pursued reckless tax cuts and an unjust war at the same time. Instead of watching the news from Iraq or reading the CBO budget reports and realizing a change in course is necessary, this Congress continues in its same folly. They are continuing to fight a war and balance a budget on the backs of the economically disadvantaged. It seems contradictory given the Republicans proclaiming themselves as the party of morality and prudence.

But if you remember, last spring they launched an assault on Social Security, the program that single-handedly lifted millions of people out of poverty. Last week the Republicans launched an assault against low-income people. Now today, we have the credit unions up here. I don't know which of the co-ops they will go after next, whether it will be the electrical co-ops or whoever, but it is really a frontal assault on the middle class's ability to financially make it. The co-ops came into existence because the banks wouldn't do it, and now we have this assault going on here. So, I have to ask the question, and somebody has to give me some reason. How many billion dollars are they going to get if they begin taxing credit unions? Anybody there who has an idea or has any data, I would like to hear it.

Mr. MILLER. Well, I guess I can start, Congressman. I think that there are two, at least two or more revenue estimates out there. One stems from a 2001 Treasury study, and I think over a 10-year period that was between $13 and $16 billion, and I think more recently a CBO 2005 document, which actually attributes the number to the joint Committee, had it at about $15 billion, so roughly——

Mr. MCDERMOTT. Over a 10-year period?

Mr. MILLER. Ten-year period.

Mr. MCDERMOTT. I saw in the GAO report something from the Tax Foundation. Who is that?

Mr. HILLMAN. That was a study that the Tax Foundation did funded by the Independent Community Bankers Association of America that estimated revenue of about $3.1 billion per year from 2004 to 2013.

Mr. MCDERMOTT. So, that would be around 13 billion, so they are sort of falling in the same category. Ms. Johnson, are you aware what the revenue figure is that they are after?

Ms. JOHNSON. I will accept my colleague's—the taxation, that is their area of expertise. However, I would say it pales in comparison with what the consumer is going to save over those same 10 years. We estimate that the credit union members are going to save up to $11 billion a year just in lower rates, lower fees, better interest on deposits. We estimate that the banking customers are going to save 4 billion, or do save 4 billion a year. Because of the minimal competition that is available, the banking customer also benefits. It is my opinion that if you have a bank and a credit union in the same community or serving the same people basically, both institutions are better for it than if you had a single institution there. That bit of competition is enough to make institutions better and it is the consumer that benefits. The money that is earned on dividends is taxed at the ordinary income level, so those individuals do pay taxes on dividends that they receive from their credit union accounts. The money that is saved by the consumer and stays in the consumer's pocket, is turned over in the economy, and hopefully a few of them will save a bit of it.

Mr. MCDERMOTT. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. Does the gentleman want unanimous consent to place his written statement in the record?

Mr. MCDERMOTT. Thank you very much, yes.

[The information was not received at the time of printing.]

Chairman THOMAS. The gentleman from Illinois wish to be recognized?

Mr. WELLER. Thank you, Mr. Chairman, and appreciate the opportunity to participate in today's particular hearing. Credit unions are a recognizable institution in the communities that I represent south of Chicago, and to be up front, I am a member of a credit union, like a lot of my colleagues, and like a lot of the staffers that are in this room as well. When I visit the local credit union back in Morris, Illinois, the Morris Community Credit Union, I see regular folks who are participating and standing in line, immigrants, working people, small business people, people in the community, that are participate in credit unions. I know my good friend from Washington State was trying to suggest that someone out there is trying to take away the tax-exempt status, and I am certainly not aware of much support for that idea. In fact, I recall we had a vote I believe in the Congress sometime in the last 10 years on that, and I believe less than 10 Members of this House voted yes to take away the tax-exempt status. So, I think that is an idea that does not have much support. What I would really like to truly understand is exactly what does the tax-exempt status for a credit union, what does it really mean to the bottom line of a typical credit union, such as the Morris Community Credit Union? And, Ms. Johnson, if you could discuss that from the bottom line of the operations of a local credit union, what does the tax-exempt status mean, and if it were not there, what would the difference be?

Ms. JOHNSON. Well, credit unions are the only financial institution that must earn their capital. They are not allowed accesses other than some low-income designated credit unions, don't have access to secondary capital. They are not stock-held institutions. So, the effect of taxation on a credit union would have behavioral changes for the management. It is because there are other restrictions on credit unions in the products and services and of how they can operate that though the tax-exemption isn't a quid pro quo for the restrictions and the exemptions, it isn't a quid pro quo. However, it is tenuous because of the incentive that it gives the management to do the best they can for their members. It is the members' capital. It is the members' money. Their sole purpose is to meet the needs of their members. It is not to meet the profit, so to speak, of the stockholders. So, everything is poured back into the credit union. The taxation I think would change behavior. Credit unions are held to a higher capital standard than other institutions. They are conservative by nature, but certainly by taxing credit unions you are going to reduce that capital, and credit unions would have to be thinking about raising rates, taking in more income in order to balance that that they have had to reduce through taxation. So, I think it is a direct detriment to the members as far as what would happen with the rates and benefits.

Mr. WELLER. Could you just elaborate further on the differences between a traditional bank, which may be on one corner, and down the street you have a credit union, and the structure and how the tax affects either the bank versus the structure of the credit union, of those institutions?

Ms. JOHNSON. I guess I would have to turn the taxation issues of the banks over to my colleagues. The dividends are taxed for credit union members, just like interest is taxed for bank customers. Let me see——

Mr. WELLER. I was going to say, Mr. Miller, perhaps you can help with that?

Mr. MILLER. Commercial banks, mutual thrifts and credit unions are all taxed differently. With respect to commercial banks and mutual thrifts, those two are taxed differently because mutual thrifts, under some circumstances, are able to deduct amounts that are distributed to their members, whereas banks are not. Both of the for-profit side of this are treated as C corporations generally, but they do have very detailed rules on taxation depending on which way they go on that. The credit union doesn't have that issue. Its income is tax-exempt. Now, as I have mentioned, depending on what the activity is and whether it is a State or Federal chartered credit union, there may be a different tax implication there, but on their business, general core business, they are simply not taxed.

Ms. JOHNSON. They still do pay payroll taxes, property taxes, other taxes of that nature.

Mr. WELLER. Thank you. I see I have run out of time. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. Gentleman from Kentucky, wish to inquire?

Mr. LEWIS OF KENTUCKY. Yes. Thank you, Mr. Chairman. I would just like to start out by making a comment about the gentleman from Washington, Mr. McDermott. He seems to like to make politically erroneous commercials from time to time here when we are trying to do serious business for the DCCC and the left wing, extreme left wing fringe, and I think if Mr. McDermott would have had his way, I believe Saddam Hussein would still be the President of Iraq, so thank goodness he didn't have his way.

Mr. MCDERMOTT. Mr. Chairman, the gentleman is out of order. You want to debate the Iraq war, let us start right here.

Mr. LEWIS OF KENTUCKY. I think you started.

Mr. MCDERMOTT. No, I didn't raise that. I raised your fiscal policies——

Chairman THOMAS. The Chair has indicated that he is trying to allow Members to make statements they wish to make. The gentleman from Washington made a statement he wished to make. The gentleman from Kentucky is making a statement he wished to make.

Mr. LEWIS OF KENTUCKY. Getting back to business—and by the way, the tax relief that we have given the American people has allowed the deficit to drop by almost $100 billion in the last year. So, I think that is a very credible and a very worthy thing that we have accomplished here in Congress for the American people. By the way, when I was a young married man in 1966, I worked for Armco Steel Company in Ashland, Kentucky, working my way through college. I took advantage of the credit union there. I was a member. It allowed me to purchase an automobile, to get a low-interest loan that allowed me to have the transportation to do what I needed to do. I believe that what credit unions do today is still just as valid as what they did in 1966 and before. The only change that seems to have happened is that there is more access for people that are in similar circumstances to what my circumstances were. I assume that the interest rates, the loan rates, and the services and the fees are still pretty much on par with what I experienced in 1966. Would that be true?

Ms. JOHNSON. I believe you would find that true.

Mr. LEWIS OF KENTUCKY. I think what was provided for me was a tremendous help in allowing me to accomplish some of the goals that I had early in life, and I am hopeful that that is providing the same opportunities for people today that I enjoyed. Thank you.

Chairman THOMAS. Thank the gentleman. Gentleman from Connecticut, Mr. Larson, wish to inquire?

Mr. LARSON. Thank you, Mr. Chairman. I have written remarks that I would like to seek unanimous consent to revise and extend.

Chairman THOMAS. Without objection.

[The prepared statement of Mr. Larson follows:]

Opening Statement of The Honorable John B. Larson, a Representative in Congress from the State of Connecticut

I appreciate Chairman Thomas calling this hearing to help people understand why it is important that these financial institutions continue to be recognized as tax-exempt organizations in order to ensure their services continue in our communities.

Since the economic crisis of the Great Depression, credit unions have played a fundamental role in providing financial assistance to people throughout the state of Connecticut and the United States. As a financial cooperative, credit unions provide many of the same products and services as banks and thrifts. Their unique operational structure, however, distinguishes them from other financial institutions. Since credit unions are owned by their membership, all the earnings are retained as capital or are returned to the member in the form of lower loan rates, higher rates on savings or to provide products and services. Credit Unions have been able to provide these substantial and valuable benefits, in part, because of the tax-exempt status they receive from the Treasury Department.

Currently, credit unions in the state of Connecticut are required by the Connecticut Department of Banking to maintain specific levels of capital for security purposes. Both state and federally chartered credit unions already pay taxes including payroll taxes, real estate taxes and personal property taxes. In the state of Connecticut, state chartered credit unions also pay Connecticut sales taxes as well. If credit unions were also required to pay federal income taxes it could hamper the ability of these institutions-to-provide sound financial assistance and reduce credit unions' abilities to build capital, restricting their ability to meet the needs of their current members or add new members.

Community banks from which many of us here and our parents received their first mortgage from or deposited their paychecks at have been one of the cornerstones of 20th Century American community development. However, over the last decade, most traditional community banks have all but disappeared from our neighborhoods, bought out, debts transferred, closed down, and turned into ATM machines on the side of shopping centers by larger and larger regional and then national banking conglomerates. Somewhere along the way, the 'community' was left behind. Credit Unions on the other hand have been serving their community members for decades, and have for many filled the void that departing community banks have left over the years.

There are still a few community banks out there, and they are still doing good work. But comparing their operating structure to credit unions is still comparing apples to oranges. In a struggling economy like we find ourselves in today, the valuable financial services that credit unions provide must be protected to ensure greater opportunities for Americans to investment in our economy.

Mr. LARSON. Thank you, sir. Just an observation. The history of credit unions in my State has been exemplary in terms of the service that they provide. I know, Ms. Johnson, you have been through this several times already in the questioning, so I will forego all of the benefits that I believe that are directly received on behalf of the constituents that I serve and represent in the State of Connecticut, and I submit my written remarks for the record, and thank all the panelists for their attendance here this morning and this enlightening conversation. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The gentleman from Texas, Mr. Brady, wish to inquire?

Mr. BRADY. Thanks, Mr. Chairman. For 18 years before coming to Congress I ran Chambers of Commerce in three different communities, and in various economies, in different recessions and boom times, I have seen how critical capital is to small business growth in a community. There tends to be an ebb and flow to it, times where as major banks merged, there seemed to be a major tightening up of credit for small businesses. I have seen somewhat a resurgence of community banks and credit unions now offering capital to small business. I am most interested in the role of credit unions. I want more capital to valid, solid entrepreneurial efforts at the local level. What and how we get there is a good debate. Can I ask each of the panelists, what is the role of credit unions in providing capital to small business start-ups at the community level, and how does that role compare to that of a community bank and the larger type banks?

Ms. JOHNSON. Many people don't realize that credit unions were originally formed for business purposes, whether it was agriculture, a lot of small business, but there were commercial—small business lending was a major part of credit unions from the very beginning. It continues to be a very important role for credit unions to play, for small businesses to have access to capital. We see a number of folks—take the military, for example. When you have someone retiring from the military after 20 years, they are just ready to begin their own small business, and having access to that capital to begin that small business with the credit union that they have been doing their transactions with for perhaps their entire military career, it makes sense for the credit union to be able to continue to serve them. The small businesses are the heartbeat of the economy, and credit unions have an important role to play in that.

Mr. BRADY. Can you address—thankfully, we have far more home-based businesses than ever before. We have far more women and minority-owned entrepreneurs entering the market than ever before, thank goodness. To each of the panelists, do credit unions play a special role in meeting the needs of that new market?

Ms. JOHNSON. Absolutely. That is where we see a lot of the growth, especially in these underserved areas, who are in many areas comprised of the minorities and the very people that you are talking about. Those are the people, the women that are perhaps coming to get the equipment for their hair salon, or someone coming in for a vehicle for their small business. Credit unions see a lot of that and that is a segment of their membership that they are reaching out now to serve. I think the whole community is better for it. There has been a sore need for access to capital for these entrepreneurs.

Mr. BRADY. Thank you. Mr. Miller or Mr. Hillman?

Mr. MILLER. Actually, I will let Mr. Hillman handle this one because the Service doesn't really have very much information on that unfortunately.

Mr. HILLMAN. We have gathered information over the years from 1992 to 2004, which shows that there is a very much a different perspective when you look at smaller credit unions and you look at larger credit unions. What we are seeing is that for larger credit unions, you are seeing them much more actively involved in first mortgage loans than that of smaller credit unions than they have been in the past. Smaller credit unions continued to tend to provide for a loan such as new vehicle loans or used vehicle loans and the like, as Congressman Lewis indicated as part of his past. As it relates to member business loans, there is current restrictions that credit unions have about the extent to which they can provide those types of loans, and over the years, since 1992 through 2004, they have been a relatively small portion of the portfolio of credit unions.

Mr. BRADY. Did you do any comparison on community banks? To a person in the community it is hard to know who is filling that need objectively. It is more anecdotal. Do you have any views or studies on who is filling the need for start-ups, home-based businesses, women-, minority-owned entrepreneurs?

Mr. HILLMAN. Not as part of this study, the credit union history, no.

Mr. BRADY. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. Gentleman from Colorado, Mr. Beauprez, wish to inquire?

Mr. BEAUPREZ. Thank you, Mr. Chairman. In the spirit of full disclosure, I am a former community banker.

Ms. JOHNSON. At least you said former.

Mr. BEAUPREZ. My wife is still chairman of the board of a bank that I still own stock in.

Ms. JOHNSON. That is fine.

Mr. BEAUPREZ. Well, thank you. I appreciate that.

[Laughter.]

Mr. BEAUPREZ. I appreciate your very, I guess, ecumenical attitude toward that. I also came to Congress with a pretty clear pledge. I didn't come here to raise taxes, and I have consistently told my credit union friends—and they are friends from Colorado; they have been very supportive of me and I appreciate that. I have told them that I did not come here to raise taxes on them or anybody else for that matter. I am pretty proud of the record we have had on this side of the aisle on actually reducing the tax burden on the vast majority of people, in fact, I think all people that actually pay taxes out there. I think the record is pretty clear on what effect that has had for our economy. I say all that just so people don't get scared as soon as a community banker, who happens to also be a Republican, opens his mouth, saying, he must be planning to tax me. The place I would like to go though, and this is the same message I have given my credit union friends, is you have to help us. So, I want to pursue in the time I have, a clear distinction that allows Congress to straight-face say this tax-exempt status makes sense.

Chairman Johnson, you have said that they exist to help people of modest means. I understand that. I think we all understand that, that that was part of the original charter. But you are not really suggesting that those are the only customers of credit unions now, are people of modest means, nor once people get out of whatever modest means status means and move on, that they no longer can be a member of a credit union, are you?

Ms. JOHNSON. Absolutely not.

Mr. BEAUPREZ. So, then credit unions don't exist only for people of modest means, nor, I am assuming—I don't want to lead the witness—but I am assuming you are not suggesting that people of less than modest means can't belong to a credit union?

Ms. JOHNSON. Congressman, the term "modest means" is certainly open for interpretation, but I would probably assume that most of us in this room and our families consider themselves people of modest means. There are others that think credit unions should serve only, quote, "the poor." I would contend that you can't have a common bond of the poor and have a successful credit union. So, you need folks that can put in deposits in order to serve those that need the loans.

Mr. BEAUPREZ. I accept that. Some banks serve people of modest means as well, right?

Ms. JOHNSON. Right.

Mr. BEAUPREZ. Same basic financial services?

Ms. JOHNSON. That is right.

Mr. BEAUPREZ. Make loans, deposits, checking accounts, that sort of thing.

Ms. JOHNSON. Right.

Mr. BEAUPREZ. Where we struggle—and Mr. Hillman, I would like to go to you next because of a statement you made—where I think we do struggle and part of the reason I think we are having this hearing, is making that clear distinction again beyond the obvious one, different ownership structure between banks and credit unions. Where we struggle is where is the service, the clear service differentiation that allows us to say, well, there is an obvious reason for tax-exempt status here. I think the statement you made—and again, I want to make sure all you credit union folks out there hear me, I am not here to raise taxes on anybody. What I am here, trying to make sure we always understand, is that there is a clear distinction as to why one is taxed and one is not. I think your closing comments went something to this effect: services are provided by State chartered—and I accept that—State chartered credit unions expand, we have the responsibility to be determining which of them generate income that is subject to unrelated business income tax and thus, which ones are not. I think you kind of set the stage. So, how do we continue doing that? I would suggest to you, Chairman Johnson, that is a test. It is a test as much for your membership as it is for us, is that that distinction that those lines don't get blurred to the point where somebody can't tell the difference. I think that is part of what we struggle with up here is the difference. Mr. Hillman, you want to respond as to what I wrote down as kind of a blurring of those lines?

Mr. HILLMAN. I think you hit the nail right on the head, and in fact, that is one of the two main reasons why credit unions enjoy their tax-exempt status, and it is also something that is very undefined in legislation. It is very vague. There is no clear standard out there as to what the requirements are, or defining an individual of smaller, modest means in order to ensure that credit unions are providing the public good that Congress is expecting, clarity in that standard would be important.

Mr. BEAUPREZ. I will just close, Mr. Chairman, if I might, that I think it is a very natural evolution from 1934 or 1916 to where we are today, that those lines have gotten blurred, but it is also a responsibility of those in Congress to make sure that—and I think that is why we are having this hearing, just asking the questions—is can we still justify what the original intent was? Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The gentleman from Georgia wish to inquire?

[No response.]

Chairman THOMAS. Gentlewoman from Pennsylvania wish to inquire?

Ms. HART. I do briefly, Mr. Chairman. I have a question mostly centering around some of the law as it is today that doesn't necessarily lead us to the point where we would want to remove a tax-exemption. I represent an area where there are many active credit unions, most of which are small and represent a very small segment—I am sorry—their members are a very small segment of the community. In communities that are what I think most people would think of as traditional credit union communities, that had lots of employees of one company. They belonged to the credit union for generations. They don't have a lot of money. They are what I think most people would consider people of modest means who belong to a credit union. I met with some of the credit union folks at home, and asked them directly, do they believe that they are still fulfilling the original mission of credit unions, and they, without hesitation, said, yes, the original mission being to provide access to people who might not really have it, and I believe that for the most part these organizations do that.

The one thing that is in the law that they enjoy, and I think one of the things that actually may cause a little bit of discomfort among my colleagues, is the issue of transparency, because the credit unions do enjoy this opportunity to not disclose a number of things. What I am curious about mostly, why are they excused from filing the forms such as 990? What purpose does that really serve? Would, perhaps, changing that part of the law, alleviate some of the concerns that people seem to have about credit unions? I think Mr. Miller may be able to help me with that.

Mr. MILLER. Congresswoman, the Form 990, again, we need to divide our world, as I have said almost every time I have spoken, into the State versus the federally chartered. The federally chartered, by regulation of many decades at this point, exempts, excuses from filing a Form 990 any instrumentality of the U.S. Government, and one of the types of instrumentalities is the Federal credit union. If we were to require that—and I do believe we could require it; we would have to modify a regulation, but we could require it—the question is why? If Congress said because we want transparency into that sector, notwithstanding the fact that that transparency doesn't lead to any tax impact, then we could do that. But again, with respect to Federal chartered credit unions, that 990 is not going to provide us with virtually any information of a tax nature. It may provide the public with transparency into the workings of an organization, but not tax information.

Ms. HART. That is okay. My goal is not tax information as much as it is to have them be responsible for providing information as other financial institutions would be. Mr. Hillman, you look like you want to say something.

Mr. HILLMAN. Yes. The GAO has noted in prior testimony to this Committee earlier this year, the need to improve governance, transparency and oversight of the tax-exempt sector. The public availability of key information about the entities, i.e., transparency, can enhance incentives for ethical and effective operation and support public oversight of tax-exempt entities, while helping to achieve and maintain public trust. The good thing about the Form 990 that you referred to are that they are public documents, and individuals, therefore, have an ability to review those documents, and that helps to maintain the public trust.

Ms. HART. Thanks, I appreciate that. The discussion with my constituent credit unions, one of the things they said that is so very important and one of the reasons why I really don't want us to be jumping to any conclusions here, is that if someone does need a $250 loan, they are certainly not going to go to a commercial bank and be able to get one. But there are credit unions in the communities I represent that do that, and I think that is a very important service. Since I have probably a minute left, Ms. Johnson, can you tell me of any reason why the organization would object to this form?

Ms. JOHNSON. What I would respect to is that currently it is not required and so we don't require it. The volunteers that serve as directors are the ones that set the salaries. The only time that we have seen a need to take a closer look is for safety and soundness reasons, if there is a credit union that we are examining for safety and soundness reasons, that there are problems, then we would look into that, but otherwise it is the purview of management. We don't set salaries, and so——

Ms. HART. So, the disclosure would present no extra burden?

Ms. JOHNSON. I don't know that it is not a burden, other than the time for reporting, but it isn't anything that we require, and therefore don't.

Ms. HART. Okay. Thank you for your indulgence, Mr. Chairman.

Chairman THOMAS. The gentlewoman from Ohio wish to inquire?

Mrs. TUBBS JONES. Mr. Chairman, Thank you very much, and thank you for hosting this hearing. For the record, I am pleased to be a part of a discussion with regard to credit unions. My prior Committee service was on financial services, and was glad to be a supporter and a founder, in fact, of a credit union in my congressional district. My first question goes to Mr. Hillman. Mr. Hillman, there are roughly 9,000 credit unions of all sizes. Of the 9,000 credit unions, have there been any issues—and maybe this should be Mr. Miller as well—with regard to credit unions compliance with any IRS or GAO regulations, or any issues with regard to that, in complying with what is the rules that are laid upon them?

Mr. HILLMAN. As part of this study we haven't looked into the enforcement actions that NCUA has taken against credit unions for certain activities and transgressions, but I suspect that the enforcement unit has had some activity in that area, but I am not aware of——

Mrs. TUBBS JONES. Surely any enforcement unit is going to have some activity in some area, or else they wouldn't be an enforcement unit. They probably would say, well, we don't need any money there. But what I am asking, trying to get an understanding, is that most credit unions meet the compliance requirements that are laid upon them. Any of you can answer the question.

Mr. MILLER. Let me say, Congresswoman, that that I think is generally the case. We have one area I think we have under investigation right now, and that is with respect to State-chartered credit unions. The array of activities that we see, particularly in the insurance area and the sale of insurance products, whether income derived from those sources is taxable under unrelated trade or business.

Mrs. TUBBS JONES. Excepting that part of that, if they are State chartered, some of the regulation actually will come under the State, not under your jurisdiction; is that fair?

Mr. MILLER. I believe that with respect to State chartered, they are regulated by the State regulator, but for Federal tax purposes on UBITs, on the unrelated business income tax, that would fall within our purview.

Mrs. TUBBS JONES. Well, lest we leave this hearing with a cloud over the heads of the credit unions of America, you are saying you believe something is being looked at, but apparently it must not be too big of a deal because credit unions continue to operate with great success and support for their members across the country.

Mr. MILLER. Let me clarify my comment, that we were talking at the edges with respect to some income. It does not go to the exemption, the tax-exemption of these entities. It goes to whether they owe some income tax.

Mrs. TUBBS JONES. Let me move on, and just say, roughly, in Ohio, that the number of credit unions in Ohio translates into about 2.7 million Ohioans that are members of credit unions. Collectively Ohioans have $6.5 billion worth of assets invested in credit unions. So, needless to say, I am getting lots of calls from my constituents about what is happening with credit unions. One is great, it is the Wright-Patt, it is our largest credit union. Then there is one in my congressional district called Safe Community United Credit Union, that stepped in to fill a void created by the desertion of traditional commercial banks from inner city areas. Again, I think there is enough room at this financial table for community banks, large banks and credit unions, and in my 7 years of being here at this table—well, not this table, but a table of the Congress, that we continue to kind of push and shove, and I just want to be on record saying there is room enough for all of you all. Let us go on to something more about. Thank you very much. I yield back my time, Mr. Chairman.

[Applause.]

Chairman THOMAS. Thank you. Obviously, that influences us. Gentleman from Texas?

Mr. DOGGETT. Thank you, Mr. Chairman. I certainly would not question the appropriateness of looking at the tax-exempt status and the tax-paying status of any business entity, but it does strike me that the priorities here and the rationale here are somewhat peculiar. We have ample evidence of commercial corporate tax dodging as the amount of corporate taxes continue to decline as a percent of our overall revenue package. We have ample evidence of abusive tax shelters, some of which involve what are called tax in different parties, or non-tax-paying parties. None of that has been considered in this Committee. We have an increasing number of commercial entities that bear a great similarity with credit unions in that they are no-tax corporations, who year after year, though they have ample multinational operations, don't pay a penny of taxes. We have some corporations that have chosen to reincorporate abroad in order to avoid any of their responsibilities. We have substantial involvement of the investment banking community in abusive corporate tax shelters along with firms that of course are facing criminal charges like KPMG.

None of those matters have been made the subject of today's hearing or other hearings. Indeed, I think it has been since 1999 that this Committee ever had a hearing that really focused on extensive abusive corporate tax shelters. Fortunately, the Senate, under the leadership of Senator Grassley, has explored some of these issues and come up with some good ways of addressing it in a bipartisan fashion, and has even dared to look at the abuses that were so costly to investors and taxpayers that Enron and similar companies have engaged in. This all, of course, does involve a substantial amount of money. I think that it would be appropriate if the goal is to really reevaluate all of these areas and their contribution to the community, to the Federal Treasury, that we look first at those who have been the subject of the greatest abuses, even though we might eventually want to get to charity hospitals and credit unions. The second thing I would note about today's hearing is that rarely does this Committee deviate from the Bush Administration party line, and I am thinking that perhaps today may be an exception. You made reference, Ms. Johnson, to a Treasury Department study that was done in 2001 concerning credit unions. Have there been any Treasury studies about credit unions since that time?

Ms. JOHNSON. That is the latest study that I am aware of. I would say, however, that your assumption is incorrect about the support of the exemption. Both President Bush and Secretary of the Treasury Snow, have both reiterated strong support for the tax-exemption for credit unions, as have pervious Administrations.

Mr. DOGGETT. Usually at a hearing of this nature, we would have an Administration witness that would testify, but as far as the Treasury Department is concerned, the 2001 study has never been questioned. The Treasury Department has never come forward and asked for legislation in this area, and the Secretary of the Treasury has spoken out in favor of maintaining the existing exemption?

Ms. JOHNSON. That is correct.

Mr. DOGGETT. As has the President of the United States?

Ms. JOHNSON. Yes.

Mr. DOGGETT. Let me ask you, Mr. Miller, has there been any requests from the Internal Revenue Service for legislative action concerning credit unions?

Mr. MILLER. Well, Congressman, legislative action and one of the reasons why my testimony takes no position is because we are not the tax policy arm of the Administration. That is a different piece, and that is where legislative suggestions would come from. But I am unaware at this point of legislative requests in this area.

Mr. DOGGETT. So, it would be Secretary Snow's Department to make the recommendations for policy changes?

Mr. MILLER. We are all in Secretary Snow's Department, Congressman, but it would be the Office of Tax Policy within his office that would push forward on tax policy matters.

Mr. DOGGETT. He is, of course, the individual who has voiced a position favoring no change in the taxation of credit unions; isn't that correct?

Mr. MILLER. I have read the speeches. That is all that I know on that topic.

Mr. DOGGETT. Thank you very much. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. It is indeed an interesting hearing that the gentleman from Texas finds comfort and protection in the Bush Administration and the Secretary of the Treasury in the Bush Administration, knowing that we know so much about the activity here, and that therefore, they could reach that conclusion. I would also remind the gentleman that the President and Secretary of Treasury are not charged with writing the Tax Code. We are. They aren't charged with overseeing it. We are. They are not charged with changing it. We are. That is why this Committee, the Committee responsible in the House of Representatives for the Tax Code, is holding the hearing.

Mr. DOGGETT. Mr. Chairman, may I ask unanimous consent at this time to insert the letter and the speech of the Secretary of the Treasury, Mr. Snow, and the President on this issue into our record?

Chairman THOMAS. Certainly, without objection.

Mr. DOGGETT. Thank you.

[The information follows:]

PRESIDENT GEORGE W. BUSH
April 30, 2004

Hon. Daniel A. Mies
President and Chief Executive Officer
Credit Union National Association
601 Pennsylvania Ave, N.W.
Suite 600
Washington, D.C. 20004

Dear Dan:

My Administration's pro-growth policies have spurred strength and vitality in our economy, and America's credit unions have played an important role in that success. By increasing lending opportunities to small businesses, families, and workers, credit unions are contributing to our economic recovery and increasing opportunities in our communities.

I support strongly the tax—exempt status of credit unions, and will continue to highlight the important contributions that credit unions make to our financial system. As service-oriented, member-owned financial cooperatives, credit unions should continue to invest in a safe and sound manner in America's future.

I look forward to continuing to work together to ensure a bright future for all Americans.

Sincerely,

George W. Bush

FROM THE OFFICE OF PUBLIC AFFAIRS
September 10, 2004

Hon. John W. Snow
Prepared Remarks:
National Credit Union Administration
Health Savings Accounts Event
Lima, OH

Thank you so much for having me here today. It's always great to come home to Ohio, and I always appreciate the chance to meet with credit union managers . . . you are such an important partner, such a valued member of the financial community.

It's wonderful to be here with my good friend Mike Oxley. Chairman Oxley is someone I regularly turn to for insight and counsel on a broad range of matters impacting the Treasury Department. I consider him to be a leader of great substance; the Financial Services Committee clearly benefits from his leadership, and the people of Ohio are lucky to have his representation in Congress.

I appreciate that credit unions are in business to do good, as well as to do business. That's clear from your motto: Not for charity, not for profit—but for service. So before I go any further today, let me say to you: I value the fact you are for service. Which is the fundamental reason why talk of taxation of your industry, and what you do, is something the Bush Administration opposes. We know that you always get less of anything you tax. And we don't want to get less of what you do.

We have a lot of things to talk about today, but I wanted to make that point clear up front.

Americans know and trust their credit unions, and this makes your role in our country's economic growth especially important. You're there for your customers whether they are opening a checking account or a small business. Whether they're saving for extra holiday spending or their child's education, you've been there.

And while our Nation's economy is doing quite well—and enormously better than it was just a few years ago—there is still much to be done, and much that credit unions will be doing to help.

Your dedication to small-business lending is one of the major reasons why I say that.

Small business is at the foundation of this great economy, and credit unions have been there for entrepreneurs when they needed you the most.

As of 2003, under the leadership of SBA Administrator Hector Barreto, credit unions were welcomed into the SBA lending programs for the first time. I hope that has helped out both you and America's entrepreneurs as much as this Administration hoped it would.

You know as well as I do: small business is where the jobs come from. We estimate that between two-thirds and three-quarters of recent net new jobs are coming from that sector.

That's why we want to make small business tax cuts permanent, and that's why I want to commend the credit union community for financing America's hard-working small-businessowners!

In addition to providing your small-business customers with the capital they need to start and grow, there is a new product that I would encourage you to market to them, and that's what we're focusing on here today: Health Savings Accounts (HSAs).

The recently enacted Medicare prescription drug bill created HSAs, an innovative new program to empower consumers to make better health care choices. HSAs are really super-charged IRAs that put patients back in charge of their health care. You own it, you control it, you can leave it to your heirs.

It's a new option for health coverage that is good news for individuals and employers who are struggling with their health-care costs.

I have good news for Credit Unions when it comes to offering this new product. First, insured credit unions are automatically qualified to handle HSAs.

Second, the reporting on these accounts is minimal. You only need to report on them once a year—to the customer and the IRS—one form to report contributions to the account and another form to report the amount that has been taken out of the account.

Best of all: you won't need any new forms. Treasury has model forms that you can use, or you can adapt the forms you use for IRAs for HSAs.

In terms of the market for this product, I believe the future is bright. As small-business customers research the services you offer, adding HSAs to your portfolio are bound to make you more attractive as the small-business financial service provider of choice.

Federal employees will also be a rich market for HSAs. Soon, they will have the option of opening HSAs and they are likely to come to their credit unions for that service.

I believe the business opportunity for you is great. Just ask the Mid-American Credit Union in Wichita, Kansas or HealthAmerica Credit Union in Jacksonville, Florida—both of whom have gotten into the HSAs business early!

And I know that you also appreciate that HSAs are good policy, a mechanism that will bring more Americans into the ranks of the insured. This speaks to your motto . . . not for charity, not for profit, for service. And affordable health insurance is a service the American people need.

HSAs are a critical step toward increasing the availability and affordability of health insurance for all Americans. They are also helping to put individuals in charge of their own health care . . . and that's something that is good news both for the American family and for the American economy as a whole.

Rising health-care costs are one of many factors that can act as a drag on our economic health. And while our economy is the strongest and most resilient in the world, it is important that we keep the burdens on free enterprise as light as possible.

We want fairness and freedom for America's small-businessowners. It's not fair to add additional burdens to their already-heavy load. Lightening those burdens gives them the freedom they need to open a business, expand it . . . or, if an entrepreneur wants to . . . to close the doors and go fishing.

Lower costs for health insurance reduces one of the top burdens on America's smallest employers—the employers who are also creating most of the new jobs.

Lowering their tax burden is critical for their health as well, and that's why the President's tax cuts paid particular attention to small business.

The President's tax cuts allowed well over three-quarters of a million small-businessowners to keep more of their business income, and encouraged them to invest in the growth of their companies. For example, nearly 860,000 business taxpayers here in Ohio will save money on their 2004 taxes.

Similarly, the tax cuts have allowed individuals to keep more of their income. More than 4.4 million Ohio taxpayers will have lower income tax bills in 2004 thanks to the tax relief. Those tax cuts helped to offset the serious blows to the U.S. including in rapid succession the bursting of the stock market bubble back in March of 2000, the economy in steep decline which President Bush inherited, the terrible behavior by high ranking corporate executives who forgot their duties to shareholders, workers and pensioners, and of course September 11th which took such a toll. President Bush saw the urgent need to act, to put oxygen into the economy and because of his leadership the American economy is now getting back onto a good course.

I am often asked: what is the most important thing I can do, as Treasury Secretary, to strengthen the American economy? And I think that people appreciate the economic significance of tax cuts . . . that is the obvious answer. But it strikes me that this question is even better answered by Education Secretary Rodney Paige. For nothing will have a bigger, more lasting impact on the American economy than educating and preparing America's work force for the jobs of today and tomorrow. Primary, secondary and continuing education—for generations to come—are by far the most important efforts toward achieving continued economic prosperity.

While recent economic recovery and growth has been impressive—with 1.7 million new jobs created in the last year, strong GDP growth, and home ownership at an all-time high—we are not satisfied, and we must always seek ways to increase growth and job creation.

You have lost jobs here in Ohio. No one knows the value of new jobs better than the people of this state.

Ohio's is an economy grounded in manufacturing, and recent years have been hard. I know what you are going through, what you have been through, and I know that it hasn't been easy. I grew up less than 100 miles from here—in Toledo, another heavily industrial town.

The people of this state have lost jobs; getting them back to work is a top priority for President Bush, and for me. We understand that the manufacturing recession that began in 2000 hit Ohio hard. And the effort to get the economy of the state on solid footing, to a place where Ohio businesses can expand, grow and create more jobs, is awfully important.

Some things we know for certain—like the fact that new jobs cannot come soon enough for the people of Ohio. The question is: where will those jobs come from?

While no one can really predict what the next high-growth industry will be, in a country where innovation is so wonderfully strong we know there will be plenty of jobs for our families. The state of Ohio overall has had some good news recently on jobs, with 3,400 new jobs created in July.

But much remains to be done. We need to return Ohio to its rightful prosperity. I remember when Ohio was a Mecca for jobs and it drew people from all across the country. I want those days to return.

I am optimistic that times will get better in Ohio. You will not be left behind; the U.S. economy is too strong for that and Ohio's workers and businesses have a long tradition of excellence and success. We're going to keep growing as a country, and Ohioans will be part of that growth.

And I know that Ohio's credit unions will be helping, every step of the way.

You understand the value of working together to achieve important goals. This quality makes you valuable to your customers, and makes you valuable to your country. More valuable because we are working together to fight the war on terror. Because while hatred fuels the terrorist agenda, money makes it possible.

As we mark the third anniversary of September 11th, I am once again reminded of the tremendous resolve in the financial community that came out of that day . . . resolve to cut off the terrorists' lifeblood: their money.

Institutions large and small have committed themselves to the task.

America's credit unions have done everything that the Treasury Department has asked of you during this fight, and I want to personally thank you for your efforts.

Your compliance with section 314 of the Patriot Act—which requires everyone to share information—has been exemplary.

We've asked that you cross-check a list of terrorists and their partners, sent to you by Treasury's Financial Crimes Enforcement Network (FinCEN), every 2 weeks, against your customer databases.

It's a big job to keep up with these lists, and it's one that is never finished. You're doing it, and our country is safer because of it.

The list that comes to you from FinCEN is an important tool—but it would be useless without your partnership. We're in this together.

We've also asked you to comply with section 326 of the Patriot Act, which has to do with recordkeeping. And I want you to know that you do have flexibility under those regulations . . . we've worked hard to make sure that your customers are able to use as many forms of identification as possible under those rules. We hope the flexibility makes it easier for you to be vigilant.

And we're always looking for ways to provide you with more and better information about our regulations. So let's keep up the dialog . . . let us know when we're confusing you, or when we can do better—because the better our regulations are understood by you, the more successful our critical enforcement efforts will be.

I know that complying with the regulations is burdensome, but it's for an important cause. We want to work with you to ease the regulatory burden while tightening our grasp around terrorist financiers.

Working together, we have accomplished a lot on this front of the war on terror in the last 3 years. The United States has designated 383 entities as terrorists or supporters of designated terrorists and frozen nearly $142 million in terrorist-related assets. More than $37 million has been frozen in the United States.

The U.S. has also identified and frozen over $4.5 million in al Qaida-related funds. In addition, almost $72 million has been frozen by other governments worldwide.

Almost 1500 terrorist-related accounts and transactions have been blocked around the world, including 151 in the United States.

Our efforts are making a difference. So please know that we appreciate our working relationship on the war on terror, and that we view you as a partner in other critical ways, as well.

You're also a partner in the effort to increase financial literacy and protect our citizens from identity theft. Both programs are critically important to the citizens of America.

For many Americans, credit unions are successful gateways for people to enter the financial mainstream through their relationships with employers, schools, community groups and other affiliations.

I want to commend you for your terrific support for financial literacy.

The Department of the Treasury has awarded the John Sherman Award for Excellence in Financial Education to several credit unions for their innovative financial education efforts. For example, in June 2003, we presented a certificate to the Ohio Credit Union League's Latino Financial Literacy Program, which provides financial education for Latino immigrants in the Columbus area. We understand the importance of your efforts.

The National Credit Union Administration also plays an important role on the Financial Literacy and Education Commission along with the Department of Treasury and 18 other agencies. This Commission is working to coordinate the Federal effort on financial education and will soon be launching a Web site and toll free hotline to provide Americans with a central source for Federal financial education information.

You do so much for your customers, and for your country . . . I'm thrilled to be here with you today, and thrilled to have you as a partner in so many efforts.

I look forward to continued work with the credit union community on all fronts, and am pleased to share with you an optimism and enthusiasm for the future of the American economy. We have a shared belief that our best days are ahead of us. I am pleased to be working toward that future together.

Thank you for having me here today.

Chairman THOMAS. Of everything that I have heard here today, Mrs. Johnson, the one statement you made I just find dumbfounding, that you cannot find a credit union back home in Iowa that you can join. If you were in California, there are ads that are run that say, "Can you join?" The response, "Are you breathing?" I think you meet that qualification. On the panel number 3 we will have a spokesperson from Louisiana, who will talk about how terrific it was that their particular credit union had exchange relationships with other credit unions, and so I could indicate that you could perhaps join a credit union here in Washington, and I can't believe there isn't a credit union in Iowa that would offer reciprocal opportunities based upon your membership in the credit union here. If that is not the case, you and I need to explore how we can create for you the opportunity to join a credit union back home. I think it is outrageous that you don't have the ability to avail yourself of the services of the very structures you are charged with overseeing.

The difficulty that I have, either in the President's statement or the Secretary of the Treasury's statement, or most of the other statements about whether or not we have a comfort level with what is going on in credit unions, is the fact that most often you have to accept statements, for example, Madam Chairman, as you gave us: "I have no doubt," "we believe," "acts of faith," are probably not comfortable enough, especially as the gentleman from Texas indicated, that there was a lot of activity out there in the corporate community. You indicated that you have CPAs who report. They had CPAs that reported. They were concerned there were reporting requirements that were burdensome and didn't want additional reporting requirements. We now have an individual serving 25 years in jail based upon what he actually did. What I have difficulty in is not understanding, as you continue to evolve and change the form of the credit union, that there isn't any more sensitivity on what could happen in terms of the downside of that evolution. Let me give you an example, and I would like to hear your response.

In 1998, the definition for community was modified using a local concept, geography. You have approved a local geographic-based credit union which has as its boundaries, Los Angeles County. That is more than 10 million people. If in fact there is an opportunity to try to serve people of modest means, there are ample opportunities in Los Angeles County. There are also ample opportunities to locate your credit union offices in ways in which you could absolutely skim those folk who make more than half a million dollars a year, if they are so inclined to use a credit union. Repeatedly, when Members asked you what do you do in terms of a measuring unit to see if people are actually providing services to people of modest means, you don't have the structure or the data capability of determining that. Does that concern you at all?

Ms. JOHNSON. Congressman, there have been some large community charters granted, and I think that has been very beneficial to those communities. They are still restricted in their geographical boundaries. They have to establish a—there has to be interaction, common interests documented. Typically, when you have a single political jurisdiction, you find those types of interaction services, a commonality among that segment.

Chairman THOMAS. Would you give me an example of the commonality other than the fact that they live in Los Angeles County? In fact, I understand that they don't even have to live in Los Angeles County to belong. They can worship or work.

Ms. JOHNSON. There is certainly commonality of public services. There is commonality——

Chairman THOMAS. Not necessarily. Somebody could be in Orange County, which is often the case, and work in LA. It is a completely different county structure.

Ms. JOHNSON. Then the interaction of the working within the county, using the facilities of the county, using the——

Chairman THOMAS. Just let me say that at this point, comparing that structure to what we started with, "I am a member of a company," "I am a member of a school district," in terms of what was the historical rationale for creating these, and you are down to now telling me that those are still substantially sufficient commonalities to allow the concept to continue, I am just saying at some point you need to maybe take a step back. In arguing in terms of the Community Reinvestment Act—and we are going to have a panelist on the third panel and I know he has a 3:00 o'clock flight, and I am going to do everything I can to get him up here—here is the question. You have tax-exemption. What is the primary reason you have tax-exemption? Is it because of the cooperative community volunteer structure of the organization, or is it because during the 'thirties, when it was clear that people of modest means were not being served adequately, given the existing financial structures of the day, that this made sense in creating opportunities for people of modest means? Which one is the primary reason you think that Congress gave credit unions tax-exemption?

Ms. JOHNSON. I think by reading the statute. that Congress was establishing an alternative provider for affordable financial services, and the structure is certainly what it is based on by having a not-for-profit with the members putting in their capital and then loaning it back out, everyone, every single member of the credit union was benefiting. That is entirely different than a structure of a stock-held institution.

Chairman THOMAS. No, no, I understand that.

Ms. JOHNSON. Having both is great.

Chairman THOMAS. I understand that, but is that the primary reason you think you get the tax-exemption, because of the structure?

Ms. JOHNSON. Reading the statute, I believe that that has been reaffirmed, yes. The structure, and there is also then to serve the savings needs and those of modest means, but I would say yes. I would say the structure, in reading the statute, the structure is the main basis for the tax-exemption.

Chairman THOMAS. Okay. But I think it is very important, and I think you should underscore this, that was included in the 'thirties is included in 1998, serving people of modest means. Earlier, I used not-for-profit hospitals as an example. The IRS has allowed not-for-profits based upon a changing definition of what their mission is, to no longer have to serve the poor. All they have to do is have a structure, and it is the structure alone that allows them that competitive advantage. But I think it is important that your structure, the people that you are supposed to administer and oversee and police, have this commitment in terms of serving people of modest means, difficult to define, as we indicated. But I have a hard time understanding why you would resist a question or not put up a structure which would allow you to show clear evidence that you do serve people of modest means, and that you serve them better than other institutions that don't have that as part of their charter. That is why I have some difficulty understanding your testimony on page 12. I assume you were presenting evidence which would convince us that you serve people of modest means, and you made a comparison with banks, and I would assume that the comparison with banks would show you favorably in serving people of modest means if you were going to include it in your information.

What you have in the last full paragraph on page 12 is that in the year 2003 "credit unions made a higher percentage of single family mortgage loans to low and moderate income borrowers . . . than banks." You were at 24.2, banks were at 23.2. You got them there by a percentage point. "In addition, credit unions significantly increased home purchase loans to low and moderate income borrowers to 28.3% of their loan portfolios at 2003." That is up from 23.6 in 2001. But you make the point, "while bank lending in this area stayed relatively constant." Well, ironically, the relatively constant rate of the banks was 28.6 percent in 2001, which was 5 percentage points better than credit unions. The point of constancy showed that in 2003 banks loaning to low and moderate income borrowers was 28.9, which is half a percentage point greater than what the credit unions did in 2003. So, in both instances the banks did a better job, according to your own testimony, of loaning money to folks of low and moderate means to purchase houses. How does that buttress your argument?

Ms. JOHNSON. Congressman, that is in part why the chart is presented above. The interpretation of the HMDA data is being done in a very different manner, and I would propose when the HMDA data is analyzed in an objective form, you will see that credit unions fare very well. If you look at the denial rates for the minority groups on the mortgage, you will see that credit unions are doing a very good job. In fact, the denial rates are lower than for other financial institutions. I would also say that those rates have improved on an annual basis. I believe as GAO had reported earlier, that the rates are getting better.

Chairman THOMAS. Of course they are getting better, but your statement, your mission, one of the reasons you get tax-exemption is because you are committed to serving people of low and modest means, and banks aren't. They pay taxes and they are beating you in a very significant, growing and important area for people of low and modest means, and that is providing personal loans on homes.

Ms. JOHNSON. The reason that this information is included is because this is information from a particular group that you will probably see elsewhere, and to be truthful in putting it in, I think that that is what we need to do, because that is information provided by one particular group that is calculated and manipulated in one fashion.

Chairman THOMAS. All I am saying is that you included that data, and I assumed you meant it to have some positive impact on us, and I am trying to figure out how it does. That is all. In addition, one of the things that shocked a lot of people was the corporate behavior, how much the chief executives were being paid, other remunerations that were available to them, the discrepancy between a typical corporation and certain corporations. What I heard in terms of your response to Ms. Hart and others was about the idea of maybe if we could get some understanding of executive compensation. We could show that there is a consistent relationship between the size of the credit union and what the CEOs get paid and there aren't any anomalies, and if there are some anomalies, you might want to focus on those anomalies. That is transparency.

But to get the transparency you have to be able to collect the data, and the argument that the law doesn't require you to collect that data, I would think, would be something you would want to talk about with the credit unions so that you don't wind up with a scandal. If your answer is, "Don't worry, there won't be one," I would be very concerned about that, especially as the way you have changed your credit union structure in which the similar relationship to join it is that you are breathing, and that it can include a geographic unit that is larger than 42 States in the United States. Those structures create opportunities for people who aren't as committed to the core concepts that created credit unions in the first place, to give you some comfort that people who work in the same place, people who are employed in the same place, who deal with similar issues.

I will tell you that I belong to the current Schools Federal Credit Union, and I understand the nexus, and I understand people are there. It continues to change a little bit, but I understand the basic nexus. I don't understand county of LA. Your explanation as to why the county of LA makes sense, I would tell you, probably isn't enough cement for the people who might join this credit union to have a very high comfort that they are going to be looking out after their own interest, the common interest that we have, the common interest that we are all in LA.

I have a little concern, because I would think you would want to be looking for tools to provide accountability, tools for transparency, tools for verifiability, because if as recently as 1998 you restated your mission as helping people of modest means, you should feel proud about proving that, and I think you could if you had the instruments that could establish that, but you don't. I would think, given the enormous discrepancy that Mr. Hillman presented between credit unions, and especially the comment about the shift from the structure of credit unions, you would want to give people some comfort that there isn't a certain structure, or you yourself would like to know that maybe some of these newer structures are simply not as responsive to the old core common ideas of a credit union that protected you in the past. So, I am kind of wondering why every time you gave an answer, it was an answer that was very, in my opinion, defensive.

I came across a court opinion in 2004 which I think illustrates the concern that a number of us have and one of the reasons we would prefer having a hearing to listen to what you are doing as the structure has evolved. The court said the "NCUA must have some gatekeeping responsibility to ensure"—in this instance—"that the local requirement be satisfied." It "cannot act as a rubber stamp or cheerleader for any application brought before it." This case is troubling because there is no indication in the record that the NCUA questioned any of the data Tooele First Credit Union (TFCU) provided, or that the NCUA queried into areas that would diminish the likelihood of finding a local community. If the NCUA had conducted any critical analysis of the information provided, it should have recognized areas of concern that required further discussion.

That to me is a cautionary signal that you should be concerned about the integrity that you could show easily and simply by the data you collect, both through transparency and through accountability, in terms of rules that are applied to other institutions that have a slight different tax structure, but which you should talk about emulating so that it doesn't bite you. But to say "I believe" or "I have no doubt" in today's world with the evolving structure of credit unions, I personally believe puts you at great risk. I would just caution you that Mr. Hillman and the GAO have provided you with some structures. I know you are taking a look at it. Cheerleading probably doesn't serve the clients of the NCUA as much as a very careful analysis of where you might get tripped up, in which public disclosure might be made, and that the credit union movement is damaged far beyond the individuals who conducted themselves in ways that certainly weren't typical of the way credit unions were supposed to conduct themselves. The old original structure virtually guaranteed that it wouldn't happen. The new structure, I think, is going to cause a number of people some real concern if there is no ability to prove, not on faith, but on structure and information, that the compensation, the accountability and the mission are all being served.

So, I would think simply from a defensive point of view that you would be anxious to find those tools, some of them indicated by the GAO and others, so that you could readily provide the data that would dismiss any argument, and perhaps in collecting the data, you might find that there are some outliers that you would be very concerned about, but you don't know about them now because you don't collect the data. That would be an early warning system that some of the new and novel directions that you are going are perhaps fraught with a little more peril than the old typical structure, which I think made a lot of sense, still makes a lot of sense today, and serves clearly defined groups. Frankly, peer group review is usually one of the best ways to keep people in line, and that is based upon the structure. I just have to tell you, I have a very difficult time understanding peer group review when what you have in common is that you either worship, work, go to school, or live in a county that has a population greater than 42 of the 50 States. That is really the point I wanted to make after having listened to all of the members in terms of the questions that they had, just as a prudent thing you might want to think about doing sooner rather than later. Any reaction?

Mr. MCDERMOTT. Mr. Chairman?

Chairman THOMAS. I wanted to know if the chairman had any reaction to the statement.

Ms. JOHNSON. Thank you for your comments, Congressman. We realize that this is an issue, and we have met with GAO, and we do intend to respond.

Chairman THOMAS. But I think you should look at, for example, the 9nineties, which would provide you with some of the compensation that is going on. I know you are not required to do them, but perhaps some kind of a cooperative effort to examine exactly what tripped up some of those other corporations on accountability, on thinking that a CPA structure worked, on relying on folk that you can't tell me by a thorough examination actually did what they said they did. I mean I know those things are unseemly, but in today's world I think just to protect credit unions, the Agency created to protect them would want to have an oversight function more than a cheerleader.

Ms. JOHNSON. I would add that many of the credit unions have voluntarily adopted many of the requirements in Sarbanes-Oxley, not required by statute to do so, but many credit unions have moved that direction. We encourage it. We have put out guidance on Sarbanes-Oxley, and that transparency is also beneficial.

Chairman THOMAS. Do you think we are probably worried about those who voluntarily adopted Sarbanes-Oxley?

Ms. JOHNSON. I would say it is—I may have used that word a little loosely. We have put out guidance and we have strongly encouraged many of the Sarbanes-Oxley procedures.

Chairman THOMAS. I understand the cost and the difficulty of complying. I think it makes all kinds of sense to figure out at what level, given the risk of something going wrong, especially since the small ones have that tighter old-fashioned structure, would you draw a line, that you would say below this level and this structure, there is not that great of a concern, you don't necessarily have to comply; above that, moving in the new direction with all of these different opportunities, especially outreach with for-profit structures in alignment with a not-for-profit structure, that this is probably a prudent thing to really think through, given the size of multibillion dollar operations and the opportunity in a whole new environment to put you people at risk in a way that you never thought you would be at risk. I am reacting to the way you thought you were at risk with this hearing, when all I wanted to do was to ask you to look inward and do the kinds of things that you need to do to protect yourself so that what happened to corporations doesn't happen to you. I agree completely the old structure pretty well protected you. You are off into areas now that are vastly different with amounts of money that are vastly different, with people who become leaders in the movement, who want to create new structures vastly different than what you had 25 years ago even, and certainly different than 50 years ago.

I would very much like to see, and in fact will make sure on a follow up that we do it, that you have got some structures, you are asking questions. There is never a problem when you ask a question and the answer is a verifiable-certified-backed-up-with-information, no. The fact that you didn't do it would be of great concern, especially given the Federal role you play in your oversight. Okay? Thank the panel very much. Anticipate the second panel.

Mr. BECERRA. Mr. Chairman?

Chairman THOMAS. Anticipate the second panel.

Mr. BECERRA. Mr. Chairman.

Chairman THOMAS. I tell the gentleman we have been here, and I accommodated everyone who was here when the Chairman began the final statement, and the Chairman said at the beginning of the hearing that the Chair would conclude with the questioning. The gentleman will have ample opportunity to question a number of other people on different panels.

Mr. BECERRA. Mr. Chairman, I was here before the Chairman started his final remarks. He never said that this was his final statement. I was here prior to that. I was here prepared to ask my 5 minutes of questioning. I believe under the rules of this Committee and this Congress, this House, I am entitled to 5 minutes to address the panel. So, unless I don't understand the rules, I am not sure why I would not be entitled——

Chairman THOMAS. I tell the gentleman that the gentleman that spoke just prior to the Chairman was the gentleman from Texas who sat next to him, and I have to tell you that I saw the gentleman from Texas in his entire profile.

Mr. BECERRA. Mr. Chairman——

Chairman THOMAS. However, the Chair wants to make sure that no member, regardless of how brief their appearance in the Committee, is shorted in terms of their opportunity to ask questions. Does the gentleman from California, Mr. Becerra, wish to inquire?

Mr. BECERRA. Under regular order, Mr. Chairman, yes, I would.

Chairman THOMAS. The gentleman is recognized for 5 minutes.

Mr. BECERRA. I thank the Chairman. I thank the panel for being here such a long time. Let me ask a couple of questions of Ms. Johnson, because I think the Chairman brought up some good points that I believe a number of the credit unions in the industry are trying to address, and I think others could be encouraged to do more. It seems to me that there has been a good purpose served by giving credit unions an opportunity to have options on how to service modest income, low-income communities in this country so that they can avail themselves of financial services. It seems, though, that most of the studies do show that the credit union industry is still lagging far behind, substantially behind even banks and thrifts, in making loans to modest income communities, especially communities of color, and, in some cases, when it's compared to women. I know that a few years back in 2001 or 2000, there was a proposal before the administration to try to provide for something similar to what CRA does within the financial services industry for banks and savings and loans. That proposal, the community action plan, which was initially approved by NCUA, was subsequently reconsidered. I know that the reasons having been given were that NCUA was preferring to use a carrot versus a stick approach. I guess my first question would be: How long do we feed carrots before we think we need to use a stick to make sure that the credit unions do move forward and do a much better job of fulfilling the charter passed in the thirties that we try to service modest-income communities through credit unions?

Ms. JOHNSON. Well, it has been the belief of NCUA that the credit unions are serving members of modest means and those in the community because they can only serve their members. In 1998, Congress had debated at length CRA requirements and whether they should be imposed on credit unions, and at that time, there was no evidence to show that it was necessary for credit unions.

Mr. BECERRA. Would you say that is still the case?

Ms. JOHNSON. We have——

Mr. BECERRA. With the evidence that is before you now, some of the analyses that have been done, would you say it is still the case that there is no need to try to have further encouragement for credit unions to do a better job of serving low-income or modest-income communities?

Ms. JOHNSON. Well, actually, Congressman, most credit unions that have adopted underserved areas are actually growing three times faster than other credit unions. We see the results that they are reaching out into the community when they have that opportunity for a community charter or through adoption of an underserved area. Otherwise, if you are dealing with employer groups, et cetera, many of those people are restricted through that employee group. There are others in the community that could probably benefit from a credit union that aren't being—cannot walk through the door and join the credit union.

Mr. BECERRA. I think you sort of point out that, on the whole, credit unions are still fairly small compared to banks and savings and loans. I think Citibank by itself is bigger than all the credit unions in the country combined——

Ms. JOHNSON. Actually, the——

Mr. BECERRA. In terms of total assets.

Ms. JOHNSON. Actually, the top three banks—the three biggest banks, any one of them is larger than the entire credit union industry combined.

Mr. BECERRA. To some degree, in response to the exchange you had with the Chairman, you can only do what the law permits you to do. How you go about enforcing these laws with regard to outreach into low-income communities is dependent on what the law permits you to do. The laws which are passed by this Congress, to some degree, dictate, they prescribe to you how to go about doing this. So, to some degree, I think we have to recognize that we have to tailor the law so that credit unions can go out there and encourage the membership in these modest-income communities. But the 1998 law I think did you give you an opportunity to expand membership to try to get into some of these modest-income communities. We have this year legislation that is working its way through the Committees that may come to the floor in the House at least that would likely expand the reach of membership for credit unions. While I have always supported the charter of credit unions, it seems to me that credit unions would probably serve themselves well if they did a better job of demonstrating that they were going to go into these modest income communities if the industry is going to try to go out there and have a more expanded definition of membership. So, I am wondering if you could just comment on that last question.

Ms. JOHNSON. The aspects as far as membership that are included in the proposed legislation is very limited. I believe it allows credit unions to retain single segs. If they were to become a community charter, they could retain those segs. There are actually very minimal changes to the actual membership proposals or to enlarge membership.

Chairman THOMAS. The gentleman's time has expired. I once again want to thank the panel, and at this time ask the second panel—Vice Admiral Cutler Dawson, Harriet May, Jeff L. Plagge, David E. Hayes. I would recognize the gentlewoman from Connecticut for purposes of introducing the last member of this second panel.

Mrs. JOHNSON. Thank you, Mr. Chairman. It is my pleasure to welcome Mark Macomber to the dais here to testify before the Ways and Means Committee. I have known Mark for many, many years. He is first Vice Chairman of America's Community Bankers, but he is the President and CEO of Litchfield Bancorp in Litchfield, Connecticut, a mutual organization, and has been a leader not only in banking circles in Connecticut and now nationally, but also in the communities of the Northwest Corridor of Connecticut, not only dedicated to building a strong economy, but to building strong communities, and I thank him for all he's done throughout that region and welcome him here today.

Chairman THOMAS. The Chair apologizes to the panel, and would indicate that all of you have written statements and will make them a part of the record, and you can then, as you have noticed, address the Committee in whatever manner you see fit. We might as well just go from the Chair's left to the right, and start with Vice Admiral Mr. Dawson.

STATEMENT OF VICE ADMIRAL CUTLER DAWSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF NAVY FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Vice Admiral DAWSON. Thank you, Mr. Chairman. Chairman Thomas, Members of the Committee, I am Vice Admiral Cutler

Dawson, United States Navy retired; President and CEO of Navy Federal Credit Union. I am here today on behalf of the National Association of Federal Credit Unions to address the tax-exempt status of our Nation's credit unions. We have provided the Committee a written statement, as you said, Mr. Chairman; and, however, my oral comments will draw primarily on my experience with Navy Federal Credit Union. In 2004, I completed a 34-year career in the Navy and was chosen to take the helm at Navy Federal. During that time, I have seen what the—during my time in the Service, I have seen what the credit union has done for sailors and marines. It is truly their credit union. Navy Federal began operations over 70 years ago with a group of Navy Department employees and their surplus dollars to make emergency loans to employees. At the end of the first year of operation, the credit union included 46 borrowers and total assets of $450.

We now serve sailors and marines and Navy Department employees and their families around the world through 106 members' service centers, including 21 that are overseas. Our motto is we serve where you serve. We have not strayed from our mission of serving those members who share a common bond of military or civilian service with the Department of the Navy. Last year, as I was leaving active duty, the last—one of the last things I did while on active service was I went to Iraq to review the finances of the folks that were there that were conducting the operations.

I spent the day with the Marines in Fallujah, and they spent the day briefing me on what they were about to do and what operations they were about, and what they had contemplated in the future. That night while we were having dinner, I happened to mention to them that I was retiring from the Navy, and that I had just been selected the day before to be the new President of Navy Federal. All the conversation stopped at that time about what they were doing. They wanted to know what I was going to do at Navy Federal, 'cause virtually all of them were members of Navy Federal. Some had been members for 25 years. Some had been members for 10; some for less. But to a man and to a Marine and to a woman, they wanted to know what I was going to do.

This same commitment and dedication to their members is duplicated by thousands of credit unions all over America. Navy Federal and all credit unions are not-for-profit, as you know, and that served defined memberships. We are owned by our members and we are governed by unpaid directors who are elected on the basis of one vote and one member regardless of deposits. We build the necessary operating capital by retaining earnings, earnings that if taxed would curtail our ability to do the very best of things that we currently do. But how does the Nation benefit from our tax-exempt status? I can only explain it to you in terms of the members that we serve, many of whom are sailors and marines. It allows Navy Federal to operate in overseas locations where our members are serving our Nation. As I mentioned to you earlier, we serve in 21 different locations across the world.

We also conduct financial management training through Navy and Marine Corps programs. In the first 6 months of this year, we conducted over 750 such sessions. We assist our members through budgetary counseling and debt management services at no-cost to the member. We guarantee utility deposits and security deposits for members in the Navy and Marine Corps. As you know, they move quite a lot. We provide members remote access to their accounts via the Internet worldwide, and even to ships at sea. But most importantly, we offer financial alternatives to provide lower loan rates and higher savings dividends, and I think, in some way, we keep the payday lenders at bay. In summary, Mr. Chairman, the credit union mission of meeting the credit and savings needs of customers, including the sailors and marines that serve our country is as important today as it ever has. It is with this in mind that I believe that continuing the Federal income tax-exemption for all credit unions is merited. I thank you for this hearing today, and I look forward to your questions.

[The prepared statement of Mr. Dawson follows:]

Statement of Vice Admiral Cutler Dawson, retired, President and Chief Executive Officer of Navy Federal Credit Union, on behalf of the National Association of Federal Credit Unions

Introduction

Chairman Thomas, Ranking Member Rangel and Members of the Committee, the National Association of Federal Credit Unions (NAFCU)—the only national trade association that exclusively represents the interests of our nation's federal credit unions—thanks you for the opportunity to testify here today on the tax exempt status of our nation's credit unions. NAFCU represents over 800 federal credit unions—financial cooperatives from across the nation—that collectively hold 67 percent of total federal credit union assets and serve the financial needs of approximately 28 million individual credit union members.

The universe of tax-exempt entities is very large; as of 2004 there were almost 1.4 million federal income tax-exempt organizations, not including churches and religious organizations, under § 501(c) of the Internal Revenue Code. Credit unions constitute a very small portion of that universe. In fact, our nation's approximately 9,200 credit unions account for merely 0.66 % of all federal income tax-exempt organizations. Yet while small in number, credit unions play an important role in directly serving their members, and ultimately in indirectly benefiting the American public; studies have shown that the presence of credit unions benefits not only credit union members but all Americans who use federally insured depository institutions.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes.' Because of their cooperative not-for-profit structure, credit union members find that product service offerings remain widely available to them irrespective of economic or stock market conditions. Such dependability means credit unions are not in a particular market or product offering today but out of that area tomorrow simply to bolster income. In providing quality services to primarily the middle and lower-middle class, particularly with respect to consumer credit needs, credit unions continue to fill a void left by other financial institutions.

Credit union critics have erroneously claimed that some credit unions today are no different than banks and thus should forfeit their federal income tax exempt status. Such claims simply do not stand up to close scrutiny. While credit unions—like all financial service providers—have evolved and grown over the years to meet the changing financial services needs of their members, the basic structure, philosophy and guiding principles of credit unions remain the same today as when the federal income tax exemption was granted to credit unions in 1937. Congress reaffirmed this fact just seven years ago, when as part of Section 4 of the "Findings" contained in the *Credit Union Membership Access Act* (P.L. 105–219), Congress declared that:

"Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specific mission of meeting the credit and savings needs of consumers, especially persons of modest means."

That statement remains true today, the same as it did seven years ago.

More recently, and as a part of that legislation, the 2001 Treasury Department study comparing credit unions with other depository institutions noted that credit unions "are clearly distinguishable from—other depository institutions in their structure and operational characteristics. . . . They are member-owned cooperatives, with each member having one vote regardless of the amount of a member's deposits. Moreover, they do not issue capital stock, rather they are non-profit entities **that build capital by retained earnings.** Finally, credit unions may serve only an identifiable group of customers with a common bond (e.g., the employees of a specific firm, the members of a certain organization, or the members of a specific community). (Emphasis added)."

The federal income tax exemption for credit unions was supported by then candidate and now President George W. Bush in 2000, when he stated ". . . as part of my overall commitment to lower taxes and provide more opportunities for working Americans, I support continuing the tax-exempt status of credit unions." During the 2004 campaign, President Bush reiterated that position, noting "I support strongly the tax-exempt status of credit unions and will continue to highlight the important contributions that credit unions make to our financial system." Treasury Secretary John Snow recently told a credit union audience "We oppose this talk of taxation of you and your industry . . . it's a truism I think in economics, you always get less of anything you tax. Well, we don't want to get less of what you do." Reflecting the bipartisan nature of this issue, 2004 Democratic presidential nominee John Kerry wrote to NAFCU that "I want you to know that I will continue to support America's credit unions and oppose any efforts to change the existing tax-exempt status of credit unions."

Historical Reasons for the Credit Union Tax Exemption

The 16th Amendment, which established the basis for a federal income tax, was ratified in 1913; at that point state-chartered credit unions had already been operating for four years. The federal income tax status of credit unions, however, remained unclear until 1917, when the Secretary of the Treasury asked the Attorney General for a legal opinion on the tax liability of state-chartered credit unions operating in Massachusetts. The Attorney General rendered an opinion that credit unions were exempt from federal income taxes.

In 1934, Congress passed the *Federal Credit Union Act* (FCUA), which created the federal credit union charter. The FCUA did not explicitly exempt federal credit unions from paying income tax. In 1935, however, the Commissioner of the Internal Revenue Service (IRS) ruled federal credit unions were exempt from paying federal income taxes. A 1937 amendment to the FCUA explicitly granted a federal income tax exemption for federal credit unions (12 U.S.C. § 1768 (2000)). As set forth in the 2001 Treasury Department study, "two reasons were given . . . (1) that taxing credit unions on their shares, much as banks are taxed on their capital shares, 'places a disproportionate or excessive burden on credit unions' because their shares function as deposits and (2) that 'credit unions are mutual cooperative organizations operated entirely by and for their members . . .' "

While the credit union community has continued to grow and evolve in the changing financial marketplace, the core justifications for which Congress granted federal credit unions a tax exemption have not changed. Credit unions still operate as not-for-profit financial cooperatives, according each member an equal vote in credit union operations.

Bankers' Myths vs. the Credit Union Reality

Some critics of credit unions would have you believe that credit unions pay no taxes at all. Credit unions, however, still pay many taxes and fees, among them payroll and property taxes, but Congress has determined that federal income taxation of member-owned shares in a credit union would put a "disproportionate and excessive" burden on credit unions. It is also important to note that share dividends paid to credit union members are taxed at the membership level.

These same critics would have you believe that credit unions are today no different than banks. The defining characteristics of a credit union, no matter what the size, however, remains the same today as they did in 1937: credit unions are not-for profit cooperatives that serve defined fields of membership, generally have volunteer boards of directors and cannot issue capital stock. Credit unions are restricted in where they can invest their members' deposits and are subject to stringent capital requirements. A credit union's shareholders are its members (and each member has one vote, regardless of the amount on deposit), while a bank has stockholders.

While credit unions have grown, like all financial institutions over the years, the credit union community remains quite small when compared to the size of the banking community. federally insured credit unions had $647 billion in assets as of December 31, 2004, while FDIC-insured institutions held over $10.1 trillion in assets.

Last year Federal Deposit Insurance Corporation (FDIC)-insured institutions grew by an amount exceeding the total assets of all credit unions combined.

Navy Federal Credit Union, the world's largest with just over $22.9 billion in assets, is dwarfed by the nation's largest bank with over $967 billion in assets. Furthermore, several of the nation's largest banks have total assets greater than the entire credit union industry. We would also note that in December of 1980 the credit union share of total financial assets was 1.4 percent. According to Federal Reserve Board statistics, 24 years later, as of December 31, 2004, credit unions' share of financial assets was still only 1.4 percent. Banks, on the other hand, accounted for 18.7 percent of household assets as of December 31, 2004.

Finally, while banks continue to attack the credit union federal income tax exemption, the number of banks that pay no corporate federal income tax continues to rise through the increased number of banks organized as Subchapter S corporations and through the utilization of other tax avoidance measures. According to NAFCU's analysis of FDIC call report data, as of December 31, 2004, nearly 24% of all FDIC-insured institutions paid no federal corporate income tax as Subchapter S corporations. These 2,139 FDIC insured institutions not only account for nearly 24% of all FDIC-insured institutions; they collectively hold over $322.5 billion in total assets, or just under 50% of the total assets of all federally-insured credit unions combined. Of these 2,139 FDIC-insured institutions that paid no corporate federal income tax, 1,077 of them (ranging in size up to $9.5 billion) paid no income tax of any kind.

Limitations on Credit Union Capital

Credit unions support sound economic policy and goals. At the same time, credit unions must adapt to changing membership needs. Credit unions must also create sufficient return on members' deposits to establish sufficient reserves. Unlike other financial organizations, credit unions have no stockholders and no access to the capital markets. Credit union reserves, therefore, serve several needs.

- They are a source of funds for assuring that credit unions meet the statutory requirements for safety and soundness.
- They allow credit unions to keep pace with modern-day financial practices.
- They are the only source of capital, which allows credit unions to offer a wide array of financial services to their members.

Furthermore, some critics argue that credit unions serve some who are not of modest means. While it is true that the average income of a credit union member has grown since the Federal Credit Union Act was enacted in 1934, a 2004 Filene Research Institute study entitled "Who Uses Credit Unions" found that the average household income of those who hold accounts solely at a credit union was less than $43,000, while the average household income for those who solely hold accounts at a bank was almost $77,000.

Additionally, because credit unions can only raise capital from the deposits of their members, the cooperative nature of the credit union means that the deposits of the entire membership allows the credit union to have the money to make loans and provide services to those who may not have significant deposits.

The Credit Union Income Tax Exemption Benefits Everyone

Although banks claim there is "competition" from credit unions, banks continue to acquire record profits. An article in the January 31, 2005 issue of the *American Banker* newspaper entitled "Feeling Heat from Deposit Competition," reported that "Zions Bancorp [of Salt Lake City, Utah] was one of the many large regional banks that while making record profits for the 4th quarter of 2004 and for the calendar year, gave in to deposit pricing pressure in the fourth quarter [of 2004]." The article continued: "Zions said pressure from other banks and specifically credit unions in Utah prompted it to raise rates on money market accounts by 20 basis points late in the fourth quarter."

A September 2004 report and analysis by Robert M. Feinberg, a professor of Economics at American University, entitled "An Analysis of the Benefits of Credit Unions to Bank Loan Customers," found that "a substantial credit union presence in local consumer lending markets has a significant impact on U.S. bank loan customers, saving them at least $1.73 billion per year in interest payments." A January 2005 study by Robert J. Tokle, a professor of Economics at Idaho State University, entitled "An Estimate of the Influence of Credit Unions on Bank CD and Money Market Deposits in the U.S.," estimated that bank customers benefit to the tune of $2.0 to $2.5 billion annually just in interest on deposits due to the competitive presence of credit unions. The credit union federal income tax exemption, therefore, does not benefit solely credit unions and their members, but each and every American who uses a federally insured depository institution.

Consumer advocates have also recognized and supported the federal income tax exemption for credit unions. In the fall of 2003 the Consumer Federation of America (CFA) examined the federal income tax status of credit unions and reaffirmed these points in a study entitled "Credit Unions in a 21st Century Financial Marketplace." In the study, CFA concluded, among other things:

- The benefits that credit unions deliver to the public far exceed their costs, as measured by the tax exemption, through lower priced services and higher interest rates; and,
- The value of tax breaks enjoyed by banks is "far greater, in absolute and relative terms, than the value of the credit union tax exemption."

The Loss of the Federal Tax Exemption Would Raise Safety and Soundness Concerns, Adversely Impact Member Rates and Fees, as well as Increase Conversions to Banks

Federally insured credit unions must build their capital reserves through retained earnings and all are prohibited from accessing the open capital markets by law. As noted by former NCUA Chairman Dennis Dollar in a letter to The Honorable Sheryl Allen (a member of the Utah State House of Representatives) regarding potential safety and soundness implications from the taxation of credit unions in that state: "it is certain that any resulting net worth considerations that might arise (from taxation) could indeed become a significant issue . . . [as a result of] credit unions having their retained earnings negatively impacted [by taxation]."

Any taxes imposed on credit unions would, because of their structure, most likely also adversely impact members' savings rates, borrowing rates and fees—creating a tax increase on America's 87 million credit union members. In addition, credit unions' boards and management would be driven to make decisions in a manner similar to banks, with the end result being a decision-making process driven by tax considerations or other issues rather than what is in the best interest of members. As a result, a very unfortunate consequence could be a shift in orientation imposing a broader economic cost, as noted in the Congressional Budget Office's July 2005 Background Paper, "Taxing the Untaxed Business Sector."

Finally, credit union boards would also have to carefully evaluate alternative business models. Today federally insured credit unions are more heavily regulated than any other financial depository institution, with restrictions on capital, who they can serve, investments and—in the case of the federal credit unions—a usury ceiling of 15%. (Federally insured credit union member business lending is also more restricted than that of either banks or thrifts.) Over the past 9 years, 29 credit unions have converted to mutual thrifts and 18 of those have taken the following stop of becoming stock-held institutions. Most recently, two credit unions in Texas, Omni Credit Union with $1.1 billion in assets and Community Credit Union with $1.4 billion in assets converted to mutuals. A likely consequence on taxation would be an increase in such conversions. Such conversions could lead to job losses of credit union employees.

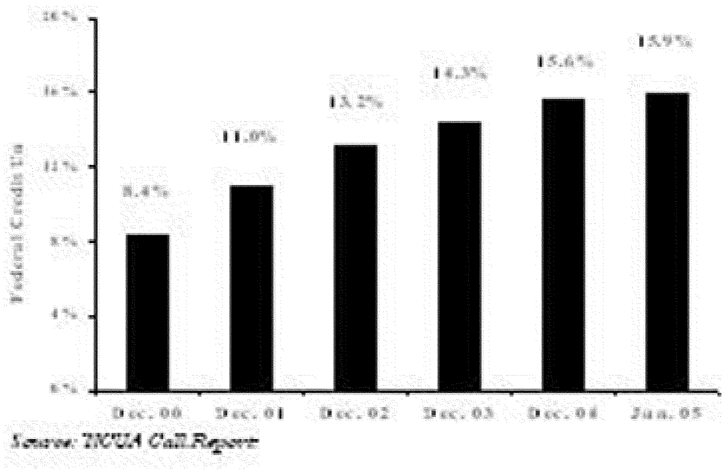
Credit Unions Pay Their Own Way

The deposit insurance of federally insured credit unions is self-funded through a cooperative system that has never cost the American taxpayer one dime. It was started with money from credit unions, and pursuant to the *Deficit Reduction Act of 1984*, all credit unions with federal insurance deposited in the National Credit Union Share Insurance Fund (NCUSIF) an amount equal to 1 percent of their insured shares (12 U.S.C. 1782) to recapitalize the fund (a move that also helped to reduce the federal deficit). Credit unions also pay the full administrative costs of their federal regulatory agency, the National Credit Union Administration (NCUA). Fees levied on credit unions *cover the entire cost of NCUA's expenses* for chartering, supervising and examining credit unions, and for administrative overhead. With today's federal budget expenditures approaching $2.48 trillion, credit union members can be proud that the taxpayers are not charged for NCUA's operations—the cost of which will be an estimated $148 million in FY 2005.

Credit Unions Service to their Field of Membership

Federal credit unions continue to actively reach out to low- and moderate-income borrowers. As a result of the low-income designation or adding of underserved areas, federal credit unions are striving to provide greater access to low- and moderate-income individuals for much needed financial services. In addition, federal credit unions engage in partnerships with consumer organizations and participate in various government programs in their efforts to enhance their services to those in financial need.

Chart 1
Low-Income Designated Federal Credit Unions



Some federal credit unions are designated specifically as low-income credit unions;[1] they predominately serve low-income members, and the number of federal credit unions with this designation is increasing (see Chart 1).

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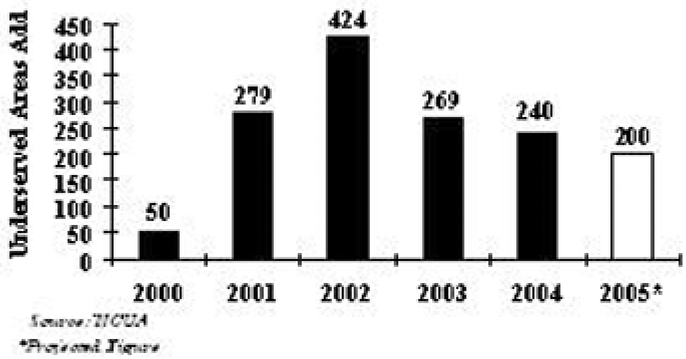
[1] A "low-income credit union" is a credit union in which the majority of its members, or the majority of residents in the community the credit union serves, makes less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or have an annual household income that falls at or below 80 percent of the median household income for the nation as established by the Census Bureau. 12 C.F.R. ϕϕ 701.1, 701.34.

Chart 2
Total Number of Underserved Areas Added to Federal Credit Union Membership
2000-2005*

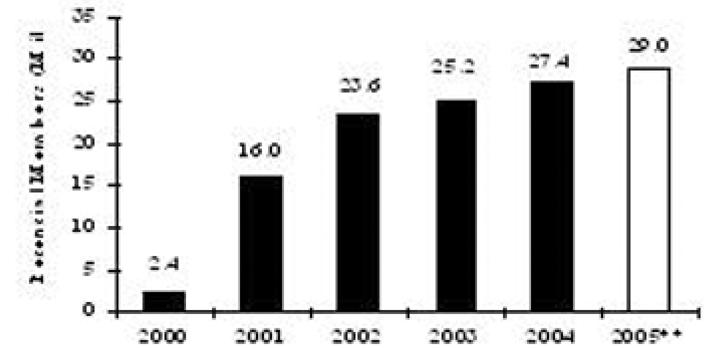


Addition of Underserved Areas

Credit unions continue to add underserved communities to their fields of membership.[2] All types of federal credit unions have added underserved areas, with the greatest participation coming from multiple-common-bond credit unions, followed by single-sponsor credit unions and then community credit unions. The number of areas added this year is expected to reach 200 (see Chart 2 previous page), a slightly slower pace than during 2004.

[2] An underserved area is a local community, neighborhood or rural district that is an "investment area" as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994 (12 USC § 4703(16)). 12 USC § 1759(c)(2). Examples of areas that qualify as investment areas include: an area where at least 20 percent of the population is living in poverty; an area where the unemployment rate is at least 1.5 times the national average; or an area meeting the criteria for economic distress as established by the Community Development Financial Institutions Fund (CDFI) of the U.S. Department of Treasury.

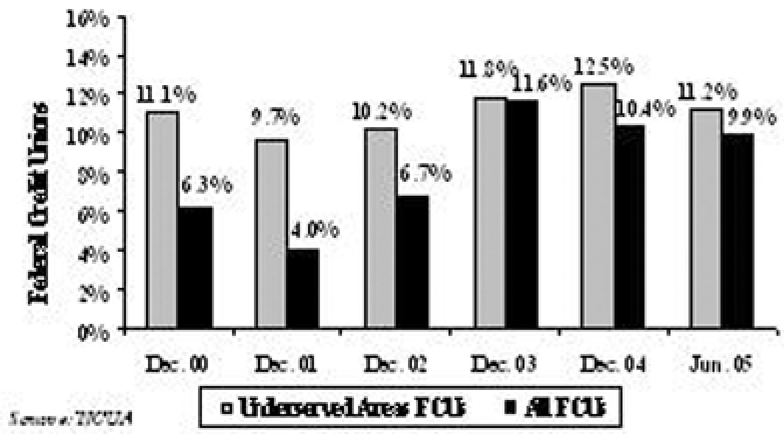
Chart 3
Potential Underserved Member-Owners Added to FCU Membership
January 2000-December 2005*



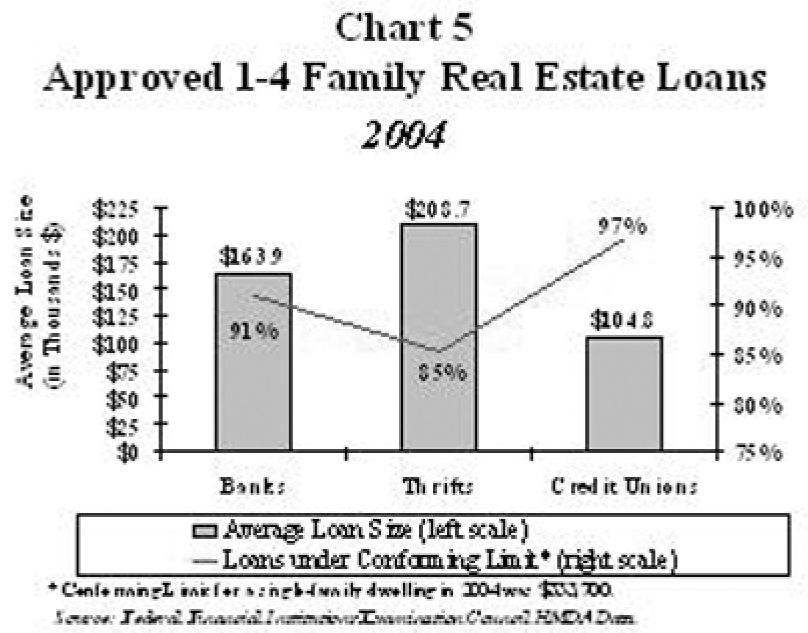
Source: NCUA
**Projected Figure*

Despite the slight decline in the pace of adding underserved areas, the number of potential members in underserved areas continues to grow (see Chart 3). As of September 2005, the potential number of members in underserved areas added to the Fields of Membership (FOM) of FCUs was 21.6 million. By the end of 2005, FCUs are projected to add to their FOMs underserved areas with approximately 29.0 million potential members. This figure is slightly higher than the 2004 figure of 27.4 million.

Chart 4
Loan Growth Trends
Underserved Areas FCUs vs. All FCUs

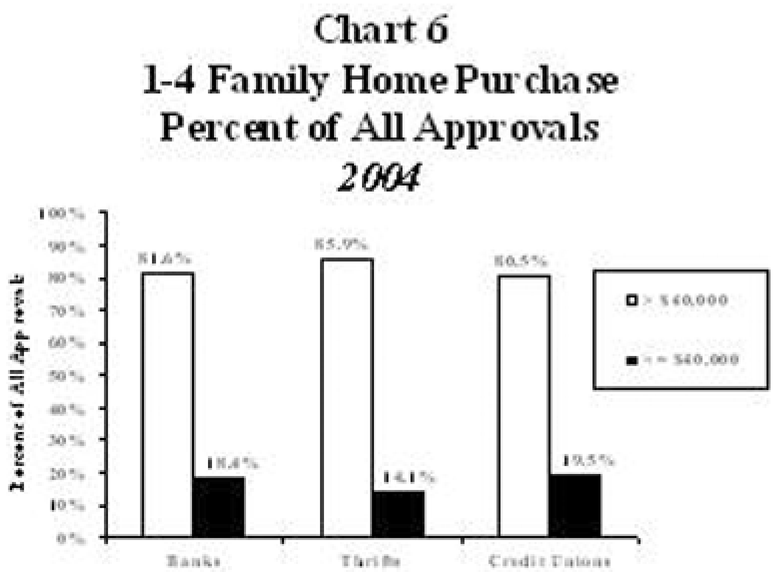


Finally, FCUs with underserved areas as part of their FOMs have achieved greater loan growth than the FCU community as a whole (see Chart 4), reflecting the extent to which FCUs have taken advantage of the opportunity to serve their members in these underserved areas.



Mortgage Lending to Low and Moderate-Income Members

Based on the most recent Home Mortgage Disclosure Act (HMDA) data, credit unions tend to make smaller mortgage loans than other financial institutions and have a higher percentage of mortgage loans to low- and moderate-income borrowers. Among all mortgage loans approved in 2004 for 1–4 family home purchases, the average loan size by banks was over 50 percent larger than the average loan size by credit unions, and the average loan size by thrifts was almost 100 percent larger than credit unions. In addition, the percentage of mortgage loans under the conforming limit of $333,700 is higher among credit unions when compared to other financial institutions (see Chart 5). Also, the percentage of credit union mortgage borrowers with applicant income of $40,000 or less is higher among credit unions (see Chart 6).



Credit union approval rates also exceed that of banks and thrifts (see Table 1 next page). In this regard, the loan approval rate, rather than the proportion of total loans granted to low- and moderate-income applicants, is the best indicator of credit unions providing service to such applicants, because the loan approval rate does not depend on field of membership type, or the geographical area served.

In 2004, the HMDA data collected, for the first time, included information on the interest rate charged on mortgage loans. The information was collected on the interest rate spread between the mortgage loan annual percentage rate (APR) and an applicable Treasury security yield. If the difference between the APR and the Treasury yield were less than three percentage points for a first-lien loan and less than five percentage points for a subordinated-lien loan, there was no reporting requirement. Credit unions had a significantly smaller percentage of loans mandating reporting (see Table 2) than either banks or thrifts, not only with respect to all mortgage approvals, but also with respect to those of household incomes less than $40,000 and those granted to minority applicants.

Table 1—Mortgage Loan Approval Rate*

1998	All Applicants		White Applicants		Minority Applicants	
	Household Income		Household Income		Household Income	
	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More
Credit Unions	85%	93%	88%	94%	72%	85%
Banks	71%	88%	75%	89%	57%	77%
Thrifts	69%	89%	72%	90%	60%	82%
2001						
Credit Unions	84%	94%	87%	95%	70%	86%

Table 1—Mortgage Loan Approval Rate*—Continued

1998	All Applicants		White Applicants		Minority Applicants	
	Household Income		Household Income		Household Income	
	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More
Banks	70%	87%	74%	89%	60%	78%
Thrifts	77%	89%	80%	90%	67%	82%
2004						
Credit Unions	81%	92%	84%	93%	66%	84%
Banks	70%	84%	73%	85%	59%	76%
Thrifts	71%	82%	74%	84%	59%	77%

Source: Federal Financial Institutions Examination Council HMDA Data
*Loans originated plus loans approved but not accepted as a percent of all loan applications. Minority applicants include those who identified themselves as Native American, Asian/Pacific, Black or Hispanic

In conclusion, today, there are more low-income designated credit unions, and more underserved areas are being added every year. When compared to banks and thrifts, credit unions approve real estate loans that are smaller in size, approve a greater percentage of conforming real estate loans, have a greater percentage of real estate borrowers with less than $40,000 income, and grant fewer real estate loans charging three percentage points or more above the Treasury benchmark.

Table 2—2004 Approved 1–4 Family Purchase Loans

Percentage of Approvals with Rate Spreads>=3%**

Percentage Reporting Above 3 Percent Spread	All Applicants (with race data)		White Approvals		Minority Approvals	
	Household Income		Household Income		Household Income	
	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More
Credit Unions	4.0%	2.7%	3.9%	2.7%	5.0%	3.0%
Banks	10.5%	7.2%	9.5%	6.4%	16.8%	12.5%
Thrifts	7.8%	5.1%	7.3%	4.7%	11.1%	7.6%

Source: Federal Financial Institutions Examination Council HMDA Data
** Approvals equal loans originated plus loans approved but not accepted. Rate spread is the difference between the annual percentage rate (APR) of the loan and the applicable Treasury yield of a comparable period of maturity. The rate spread is reported only if it is equal to or greater than 3 percentage points for first-lien loans and 5 percentage points for subordinated-lien loans. Minority approvals include those who identified themselves as Native American, Asian/Pacific, Black or Hispanic.

Taxation of Credit Unions Would Harm America's Consumers

If credit unions were taxed, there are many possible results, over time, for credit union members. Some of the results include:

- **Credit Unions Would Lose their Identity:** By necessity, credit unions would become more driven to increase profits in order to pay taxes and customer service—one of the hallmarks of the credit union philosophy—would likely suffer.
- **Rates and Fees:** Monies paid in taxes would adversely impact saving rates, borrowing rates, and fees.
- **Capital:** Further restraint on the ability to raise capital, potentially impacting safety and soundness.
- **Erosion of the Volunteer Base:** As credit unions become "more like banks," the self-help characteristic of credit unions and the community as a whole would become less distinct.
- **Conversion to Other Business Models:** Given the significant regulatory burden that credit unions already carry, there is a strong likelihood that the rate of conversions to mutual thrifts would increase, this could result in a loss of jobs for credit union employees.

Tax Status of Subchapter S Banks

Today, the banking trade associations have attacked the credit union tax exemption as a remnant of the past, an unfair advantage that is undeserved despite credit unions' not-for-profit, cooperative structure. NAFCU disagrees with these sentiments. The bank attacks on the credit union tax exemption ring hollow and hypocritical in light of the growing number of Subchapter S banks. Like credit unions, Subchapter S banks do not pay corporate income tax.

Under a provision in the tax code implemented in 1996, banks that qualify as Subchapter S corporations are exempt from paying corporate income tax. In 1996, Congress included a provision in the *Small Business Job Protection Act* (P.L. 104–188) that allows banks that do not use the reserve method of accounting for bad debt to qualify as small business corporations and therefore, qualify as Subchapter S corporations. In Subchapter S corporations, the tax at the corporate level is removed, and only the shareholders pay an income tax. Previously, banks were not allowed to qualify as Subchapter S corporations because banks already enjoyed a substantial tax advantage in the method in which they were allowed to account for bad debt.

Since passage of *Small Business Protection Act,* the number of Subchapter S banks has steadily increased. In 1997, there were 604 Subchapter S banks. Today, there are 2,139 Subchapter S banks with total assets of $322,461,619,000. The largest Subchapter S bank is Emigrant Savings Bank, a thrift, with assets of $10,267,659,000.

Critics of the credit union community argue that large credit unions have outgrown the historical justification for the tax exemption, ignoring the fact that it is the structure of the credit union is an important justification for the tax exemption. Few, if any, critics would argue that all credit unions should be subject to taxation. Instead, opponents try to distinguish between large credit unions—which they argue should pay taxes—and small institutions with limited assets and basic services.

Subchapter S corporations, however, enjoy the exemption from corporate level income taxes without any restraints, real or proposed, on their asset size. Currently, there are four main requirements to qualify as a Subchapter S bank:

- The total number of shareholders cannot exceed 100;
- Second, shareholders must be individuals or other certain trusts;
- Third, the corporation can issue only one type of stock and;
- Fourth, the bank may not use the reserve method of accounting for bad debts.

As the requirements make clear, banks may qualify as Subchapter S corporations, and reap the tax benefits, regardless of their asset size, or the services they provide. It would be inequitable to impose an income tax on not-for-profit, cooperative credit unions based on asset size, while for-profit Subchapter S banks—operating with fewer regulatory restrictions—remain untaxed regardless of their size or the sophistication of the services they provide.

Conclusion

In summary, the structure, philosophy and guiding principles for credit unions, large and small, remains the same today as it was in 1937; i.e., they continue to be member-owned, democratically-controlled, not-for-profit cooperative organizations managed by volunteer boards of directors with the mission of meeting the credit and savings needs of consumers, especially persons of modest means. Thus, we believe there is more than ample justification for continuing the federal income tax exemption for all credit unions, regardless of size, charter type, field of membership or services offered.

Chairman THOMAS. Well, thank you, Admiral. Ms. May?

STATEMENT OF HARRIET MAY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GREATER EL PASO'S CREDIT UNION, EL PASO, TEXAS, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Ms. MAY. Thank you. Good afternoon.

Chairman THOMAS. Push the button.

Ms. MAY. Got it. I know I always have to adjust this. Thank you for this opportunity, Chairman Thomas, to speak before the Committee. Thank you, Committee Members, for being here. I am Harriet May, President and CEO of GECU of El Paso, Texas, and I am testifying on behalf of the Credit Union National Association. The GECU, formerly known as Government Employees Credit Union, has served the families of El Paso County since 1932, when, at that time, 11 men pulled $5 a piece to serve their fellow civil service employees. Today, we serve the needs of over 247,000 members, with assets of over $1 billion. El Paso's population is 82 percent Hispanic, with a median household income of just under $30,000. Nearly 25 percent of families live below the poverty level. Just over 43 percent of our members have household incomes of less than $29,000. The majority of our members are low-income, so our day-to-day products and services, not just special products, must be tailored to meet their unique needs.

So, Mr. Chairman, I confess GECU is one of those big, bad billion dollar credit unions that the bankers claim have morphed into something they were not intended to be; except, quite honestly, they are wrong. They are wrong because GECU is a relatively large credit union, by credit union standards, but it is important to understand it operates under the same philosophy, the same function, and is organized in the same structural make up as occurred when it was set up in 1932 as do other credit unions. It is this fact that justifies maintaining the tax-exempt status of credit unions. My written testimony addresses the issues laid out by the Committee for review, making a strong case that credit unions earn their tax-exemption each and every day. Let's be clear from the start. The original reason for the credit union tax-exemption was based on the positive nature of credit unions.

Since 1917, the tax-exemption has been reaffirmed a number of times, most recently with strong statements in support from both President Bush and Treasury Secretary Snow. Contrary to rhetoric, the asset size of credit unions has never been the basis for considering the imposition of Federal income taxation. Additionally, whether or not credit unions make business loans has no connection to tax-exemption. Since their earliest days, credit unions have provided business loans to their members. In fact, the first Federal statute limiting member business loans was enacted in 1998. Recently, both the U.S. Treasury and congressional studies have found that credit unions are indeed fulfilling their purpose. Studies portray credit unions as robust institutions with a specialized structure serving identifiable groups of members. Meanwhile, in 1998, Congress recognized that there are five characteristics that distinguish credit unions: member ownership, net worth created by retained earnings, dependence on volunteers, and not-for-profit basis of operations; and foremost, service only to its members.

The findings concluded that credit unions are exempt from taxation because of these characteristics and because they had the specified mission of meeting the credit and saving needs of consumers, especially, but not only, persons of modest means. Even though taxing credit unions might result in $1.5 billion in annual tax revenues, as described in my written statement, consumers at credit unions and banks benefit approximately $10.6 billion a year in the form of better rates on loans, fees, and savings nearly because credit unions exist. As member-owned institutions, credit unions endeavor to offer products and services that their members need and want. As technology results in more and better offerings, credit unions must respond to their members' needs.

However, none of the core characteristics of credit unions or rationales for the tax-exemption has anything to do with credit union size, field of membership restrictions, the range of services offered, or the extent to which credit unions might not compete with financial institutions. Instead, they have everything to do with the cooperative structure of credit unions and their mission of providing affordable services to American households. It is clear that credit unions play an important role in our economy. Credit unions serve people of all walks of life, at all economic levels. Credit unions provide the public with a not-for-profit cooperative alternative to the for-profit sector. Consumers benefit by having access to lower cost services that might not otherwise be available to them. The tax-exempt status of credit unions is the glue that holds credit unions and their not-for-profit approach cooperative financing together. If the tax-exemption were removed, if 87 million Americans were forced to pay additional taxes solely because of their ownership in the credit union, it would lead to the end of a movement as we know. Credit unions would become banks, and consumers would pay a high price. Thank you, Mr. Chairman. I would be glad to answer any questions.

[The prepared statement of Ms. May follows:]

Statement of Harriet May, President and Chief Executive Officer, Greater El Paso's Credit Union, El Paso, Texas, on behalf of the Credit Union National Association

EXECUTIVE SUMMARY

INTRODUCTION (Pages 1–4)

Although GECU is a relatively large credit union (by credit union standards), and provides a wide range of services to meet the particular and unique needs of its membership, it is important to understand that it operates under the same philosophy, serves the same function and is organized under the same structural make-up as all other credit unions. It is this fact, repeated by credit unions of all types and sizes across the nation who remain true to their historic purpose and continue to provide the public need, that justifies maintaining the tax-exempt status of credit unions.

This testimony addresses the issues laid out by the Committee for review, including making a strong case that credit unions continue to meet the needs of their members, as envisioned when credit unions were created in the last century. The testimony also refutes many false and misleading statements of the banking industry in its effort to eliminate credit unions as a choice for America's consumers.

HISTORY OF THE TAX-EXEMPT STATUS (Pages 4–12)

The original reason for the credit union tax exemption was based on the cooperative nature of credit unions. Today, credit unions continue to exist as financial cooperatives, and their not-for-profit, tax-exempt status helps to assure that credit unions fulfill their role in the U.S. financial sector.

In fact, this credit union role, as a basis of the tax exemption, dates at least from as early as 1917 in Massachusetts. Since then, the tax exemption has been reaffirmed a number of times, including in 1935, 1936, 1937, 1951 and, most recently, in 1998. The 1951 reaffirmation is significant because in that year Congress repealed the tax exemption for mutual savings banks, specifically because these institutions had strayed from their commitment to mutuality.

However, in 1969, Congress extended the unrelated business income tax (UBIT) requirements of the Internal Revenue Code to cover a broad array of otherwise tax-exempt organizations. State chartered credit unions potentially became subject to UBIT under this action. (Federally chartered credit unions (as federal instrumentalities) were specifically exempt from UBIT.) From the start, this requirement has raised some difficult issues that have yet to be addressed satisfactorily by the IRS, particularly since IRS has never offered its own articulation of the purpose of state-chartered credit unions' federal tax exemption (which we believe is to enable these credit unions to function as not-for-profit cooperatives offering financial services that promote thrift). CUNA continues to work with the Service to clarify this situation.

Contrary to banker rhetoric, credit unions were established to serve the needs of working Americans, allowing them to pool their resources in self-help financial organizations. This view is rooted in the legislative history of the development of credit unions. In fact, in 1934, a Senate report noted that there was a pressing need "to eliminate the loss of buying power which now results from the fact that the masses of the people are obliged to look to high-rate money lenders in time of credit necessity." Credit unions were formed to serve these "masses," and are proud to have 87 million members today.

Never has the asset size of credit unions (which is often a reflection of the number of members a credit union serves) been the basis for considering the imposition of federal income taxation.

Additionally, while credit unions are specifically chartered to serve the needs of individual members, since their earliest days credit unions have provided business loans to those members. In fact, the first federal statute *limiting* federal credit union business lending was enacted in 1998 with the passage of the Credit Union Membership Access Act (CUMAA).

Finally, credit union earnings are the only pot of money that would be taxed at the end of the year. However, these earnings also stand as a cushion to absorb any losses a credit union might incur through changing economic conditions. Taxation would erode what credit unions could build as this cushion and, depending on economic conditions, could even undermine maintaining the net worth required by statute. This cushion not only protects the credit union itself from future challenges, but also protects the National Credit Union Share Insurance Fund.

SERVING THEIR INTENDED GOALS (Pages 12–20)

Recent U.S. Treasury and congressional studies have found that credit unions are, indeed, fulfilling their purpose. The U.S. Department of the Treasury has conducted several detailed studies of credit unions in the last eight years. These objective studies, which were requested by Congress, are exhaustive and present detailed analyses of the credit union system. The studies portray credit unions generally as robust institutions with a specialized structure serving identifiable groups of members.

Meanwhile, in 1998, the Congress wrote in the CUMAA "findings" that there are five characteristics that distinguish credit unions: member ownership, net worth created by retaining earnings, dependence on volunteers, not-for-profit basis of operations, and service only to members.

The CUMAA congressional findings also concluded that credit unions are exempt from taxation because of these characteristics and because credit unions have "the specified

mission of meeting the credit and savings needs of consumers, especially (but not only) (parenthesis added) persons of modest means."

Credit unions put these characteristics to work every day by serving all of their members, including those of modest means. In fact, recent studies have shown that households using a bank and not a credit union have higher incomes and wealth than do households using only a credit union. Other studies, specifically of data collected under the Home Mortgage Disclosure Act (HMDA), reveal that credit unions are taking advantage of greater opportunities to serve low- to moderate-income members (something they only attained the ability to do broadly within the last 10 years) and disproportionately serve LMI borrowers.

Finally, credit unions of all types remain restricted in who can join—either by community, occupation, association or some other "common bond," despite rhetoric to the contrary by America's bankers.

USE OF THE TAX BENEFIT (Pages 21–23)

Credit unions employ the tax benefit by passing it through to their members, primarily in lower rates on loans, lower fees (or none at all) and higher returns on savings. The nation's 87 million credit union members benefit by $6.3 billion a year as a result of paying fewer and lower fees and lower loan rates and earning higher rates on deposits compared to banking institutions. This $6.3 billion is not retained by just a few large stockholders. Instead it is distributed across all 87 million members based on their usage of the credit union. In fact, relatively more of the benefit accrues to lower income members than would be explained by their volume of business at the credit union because credit union pricing tends to be friendlier to lower balance accounts than at banks and alternative financial institutions.

Additionally, there are also significant financial benefits to consumers that are not members of credit unions. Recent studies have shown that bank customers benefit in the aggregate by $4.3 billion a year as a result of lower loan rates and higher deposit rates at banks as a result of the existence of credit unions. In total then, bank customers and credit union members benefit to the tune of at least $10.6 billion a year merely because credit unions exist.

CHANGES IN THE INDUSTRY HAVE NOT COMPROMISED JUSTIFICATION OF RETAINING THE TAX EXEMPT STATUS (Pages 23–28)

As member owned institutions, credit unions endeavor to offer products and services that their members need and want. And as technology results in more and better offerings, credit unions must respond to meet their members' demands, so long as they are permissible by law and regulation. In fact, over the years the National Credit Union

Administration, like the bank and thrift regulators, has on occasion amended its regulations to permit credit unions more flexibility to serve their members better.

However, there is no question that while credit unions may offer products and services provided by banks and thrifts in response to their members' needs, credit unions operate under serious constraints. As concluded by the Treasury in a recent report:

Federal credit unions generally operate within the same legal framework as other federally insured depository institutions. Most differences between credit unions and other depository institutions derive from the structure of credit unions. Credit unions have fewer powers available to them than do banks and thrifts.

Further, the relative size of a credit union, or the products and services it offers, does not affect its mission. Because of their size and efficiency, large credit unions are often more able to provide the benefits of the cooperative to members, such as lower loan rates and fees and higher dividend rates. Larger credit unions are also more able to offer special programs benefiting low- and moderate-income households.

However, none of the core characteristics of credit unions or rationales for credit unions' tax exemption has anything to do with credit union size, field of membership restrictions, the range of services offered, or the extent to which credit unions might not compete with other financial institutions. Instead, they have everything to do with the cooperative structure of credit unions and their mission of providing affordable services to American households, especially those of modest means.

CONCLUSION (Page 29)

It is clear that credit unions play a powerful role in our economy. Credit unions serve people of all walks of life at all economic levels. Credit unions provide the public with a not-for-profit, cooperative alternative to the for-profit sector. Consumers benefit by having access to lower cost services that might not otherwise be available to them, especially those of modest means. And the facts show that the banking industry, which is engaged in an effort to put credit unions out of business, continues to mislead Congress into thinking that their very existence is threatened because of credit unions and their tax status. But banks continue to earn record profits.

Recent oil industry ads in the *Washington Post* illustrate this fact. The ads point out that in fact the banking industry recorded the highest profits of all U.S. industries during the second quarter of 2005—even more than the pharmaceutical industry. While the banking industry continues earning record profits, credit unions provide a nearly 7-to-1 return to consumers on the dollar, benefiting them by over $10 billion dollars in yearly savings.

Credit unions are an important part of the financial life of American consumers. And the tax-exempt status of credit unions is the glue that holds credit unions and their not-for-profit approach to cooperative financing together. If the tax exemption were removed—if 87 million Americans were forced to pay taxes solely because of their membership in a credit union—it would lead to the end of the movement that we know. Credit unions would become banks, and the consumers would pay dearly, not only in higher taxes, but in higher fees, less return on their savings and borrowings and the loss of a cooperatively owned, not-for-profit alternative in the financial services marketplace.

Good morning, Mr. Chairman, Ranking Member Rangel, and members of the Committee. On behalf of America's Credit Unions and their 87 million members, thank you for inviting me to testify today on "A Review of the Credit Union Tax Exemption." I am Harriet May, President and CEO of GECU in El Paso, Texas. I am testifying on behalf of the Credit Union National Association (CUNA), of which I am a member of its Board of Directors. CUNA is the largest of the credit union trade associations, representing over 90 percent of the nation's approximately 9,000 state and federally chartered credit unions.

GECU (formerly know as Government Employees Credit Union) has served the families of El Paso (TX) County since 1932, when 11 men pooled $5 each to serve fellow postal workers. Over the years, the credit union's reputation for providing caring, proactive service to its members has made it the largest locally owned financial institution in El Paso. Today, we serve the needs of over 247,000 members with just over $1 billion in assets. That equates to just over $4,000 per member, a rather low number that can be explained by El Paso's demographic composition.

El Paso's population is 82% Hispanic with a median household income of just under $30,000. Nearly 25% of the families live below the poverty level. GECU's membership demographics mirror that of the community. The credit union serves 247,000 members—a third of every El Pasoan. Just over 43% of our members have household incomes of $29,000 or below.

With these demographics, GECU has not developed "special" programs to reach the underserved or low income. Rather, we recognize that because the majority of our community and the members we serve are low-income, our day-to-day products and services must be tailored to meet their unique financial needs.

We serve our members' lending needs with non-traditional products and services:

Consumer Loans

- Ready Credit line of credit—low-balance line of credit for member emergencies and other small-dollar needs. Typical loans range from $200 to $800 with the average being about $500.
- Small dollar loans—GECU continues to make loans to members to meet their needs even if the amount is only $200. This type of loan would not be considered extraordinary, but rather "normal" for our membership. It is not atypical to provide a loan for a member to purchase dentures or eyeglasses. For the year 2004, GECU funded 1,329 small-dollar loans for $518,948, an average balance of only $390.48. As one member responded in a recent member satisfaction survey, *"Doy gracias porque es el único banco que nos presta dinero en caso de emergencia con bajo interés. Gracias por todo." L. Ramirez.* ("I give thanks because you are the only "bank" that loans us money in emergencies with low interest. Thank you for everything.")
- MasterCard First—designed particularly for those needing to rebuild their credit and for individuals desiring to establish credit
- FamilyAccount MasterCard—GECU piloted this product for MasterCard. The card enables the cardholder to allocate spending limits for family members who in turn receive their own card and unique account number which they can use to make purchases up to their spending limit. Primarily designed for college-bound students in El Paso, the product serves another segment of our population—parents and other older relatives. With the Family Account MasterCard, the cardholder is able to provide financial assistance for his or her parents without stripping them of their independence.
- Through July of this year, GECU has funded nearly $38 million in mortgage loans to El Paso families; 83% of all first lien mortgage loans have been made to Hispanics; 40% of those loans were to households with income less than $38,400.
- Additionally, through July of this year, GECU has funded nearly $11 million in mortgage loans through Fannie Mae special programs, "Expanded Approval" and "My Community", both of which provide additional financing opportunities for low-income families who would not otherwise be eligible.
- GECU has been very active in El Paso City Bond Money programs, providing members with down payment assistance and lower interest rates for homes purchased in targeted areas of town. The credit union won another $3 million in September of this year and as of October 21 there is already $1.3 million in the pipeline. The entire allotment would have already been claimed if there weren't a current shortage of dwellings from which to choose in our community.
- GECU is the predominant provider of vehicle loans in El Paso, having earned a reputation for lower interest rates and finding ways to put members in new vehicles without putting unnecessary burdens on their monthly obligations.

Small Business Loans

- In response to member requests, GECU began offering small business loans to our members two years ago. Based out of the One Stop Business Resource Center in El Paso, staff works with small businesses to provide loans for working capital, expansion and inventory. We work closely with Accion, the Hispanic and Greater Chambers of Commerce, and other not-for-profit organizations dedicated to the success of small business in El Paso.

Deposit Products

- GECU offers Free Checking (no monthly service fee; no fee for excessive check writing).
- We also offer "The No Excuses Savers Club". This product enables beginning savers to open a 12-month CD with just $50. The product earns the prevailing 12-month CD rate and allows multiple deposits during the term of the CD (minimum $10). As of July, we have over 5,362 accounts totaling over $6 million with an average balance of $1,129—quite an accomplishment for our typical member, nearly all of which are of modest means.
- We offer a Christmas Club Account that enables members to save for the holidays in a 9-month CD that they appreciate because the money is "off-limits" until it matures. This helps members develop savings discipline.
- IRNet Vigo—GECU was the first credit union in Texas to offer this low-cost alternative for wiring of money, designed especially for credit unions, to foreign countries. Our members especially appreciate being able to send money to their families in Mexico for a fraction of the cost of other wire transfer services.

Financial Education

- GECU offers monthly financial education classes in English and Spanish through the El Paso Affordable Housing Credit Union Services Organization (CUSO). Participants learn the basics about credit and how to apply for a mortgage loan. The CUSO was formed in 2001 by 8 local credit unions to provide education to credit-challenged individuals with the goal of eventually preparing them for home-ownership.
- The credit union also hosts quarterly seminars for first-time homebuyers hosted by our own mortgage loan officers. These seminars are offered in English and Spanish.
- GECU's Financial Counseling experts, full-time employees of GECU, educate members about developing realistic budgets and strategies for debt-free living.
- Through year-end 2004, Financial Counselors served 637 members with $2.8 million in the program.
- GECU also partners with the YMCA with their Consumer Credit Counseling program; YMCA staff works out of one of GECU's branches to serve families with credit counseling needs.
- GECU works to begin the financial education process early and is active with local Partners in Education programs, Junior Achievement and the CTAC (Career Technology Advisory Committee)
- GECU staff takes the message of financial education to the airwaves as well. Two of our senior managers are frequently asked to appear on a local morning Spanish-language talk show where they provide educational information about financial products and services to listeners.

Being a locally-owned, locally-managed financial institution benefits the community in many ways. The credit union philosophy of "people helping people" is more than a notion, it is our commitment to GECU's membership and it is evidenced by the credit union's current loan to deposit ratio of over 98%. Nearly every dollar deposited by a GECU member has been loaned out to another GECU member; the money stays in El Paso and is put back to work for El Pasoans—their families and their businesses.

Mr. Chairman, as the Committee conducts its important oversight function, I wanted to make sure I provided you with the backdrop for my credit union, which, although large by credit union standards, operates under the same philosophy, serves the same function, and is organized under the same structural make-up as all other credit unions.

In that spirit, Mr. Chairman, I welcome the opportunity to assist the Committee in its review of the history and purpose of the credit union tax exemption. The fact is that the credit union tax exemption is one of the best investments Congress has ever made on behalf of the American consumer. Credit unions of all types and sizes remain true to their historic purpose and continue to provide the public need that justifies maintaining the tax-exempt status of credit unions.

My testimony today will address the specific issues you laid out in the Committee Advisory notice. In addressing these issues, I will clearly review the history of why credit unions are tax exempt, as well as make the case that while the nation has undergone many changes in the century or so that credit unions have existed, the need for them continues today and credit unions continue to meet that need. I also will refute the many false and misleading statements of the banking industry in its effort to eliminate credit unions as a choice for America's consumers.

HISTORY OF THE CREDIT UNION TAX-EXEMPT STATUS

The Cooperative Structure of Credit Unions

At the outset, it is important to establish that the original reason for the credit union tax exemption was based on the cooperative nature of credit unions. Credit unions today continue to exist as financial cooperatives, and their not-for-profit, tax-exempt status helps to assure that credit unions fulfill their role in the U.S. financial sector.

The Federal Credit Union Act defines a federal credit union as a cooperative association chartered "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes," language that has not changed since 1934. Cooperative banking was needed because consumers in the 1930's were not typically served by the commercial banking industry but rather by loan sharks. Senator Morris Sheppard, the key Senate proponent of credit union legislation in the 1930's, said in his remarks when introducing the bill that would eventually become the Federal Credit Union Act of 1934:

"A credit union is a cooperative bank—supplying its members with (1) an excellent system for accumulating savings which enables them (2) with their own money and under their own management to care for their own short-term credit problems at normal interest rates with all the resultant earnings reverting to the members as dividends on their savings in the credit union and as surplus."

These words could just as accurately be said today about the nation's 9,000 federal and state credit unions.

The 1934 Senate report on the federal credit union bill stated: "Credit unions also have vast educational values. The fact that credit unions of working men and women, managed by fellow workers have come through the depression without failures, when banks have failed so notably, is a tribute to the worth of cooperative credit and indicates clearly the great potential value of rapid national credit union extension."

Credit unions continue to operate as democratically controlled mutual institutions, serving their members on a non-profit basis. Credit unions do not have separate groups of customers and stockholders with competing interests—obtaining reasonably priced financial services versus assuring good stock prices and returns. Rather than distributing net income among stockholders, most of a credit union's income is returned to members in the form of lower loan rates and fees, or higher yields on savings (and credit union dividends paid to members are, of course, taxed). Some earnings are retained by the credit union to comply with statutorily mandated net worth requirements and as a cushion to anticipate future needs.

So, in spite of revisionist attempts to rewrite history, since its inception, the credit union tax exemption has had nothing to do with the size of a credit union, field of membership restrictions, or the types of services a credit union offers.

Chronology of Credit Unions' Federal Tax-Exemption

The first credit union law was passed by Massachusetts in 1909. Federal revenue laws in 1913 and 1916 contained exemptions for some mutual and cooperative entities, but did not mention these new state chartered "credit unions" by name. Therefore, in 1917 the U.S. Attorney General ruled that Massachusetts credit unions were exempt from federal income tax because:

[O]n examination of the purpose and object of such associations, it appears that they are substantially identical with domestic building and loan associations or cooperative banks 'organized and operated for mutual purpose and without profit' [the Attorney General quoting from the 1916 statute]. It is to be presumed that the Congress intended that the general terms used in Section 11 should be construed as not to lead to injustice, oppression, or an absurd consequence.

The 1917 Attorney General ruling served as the basis for the exemption of state chartered credit unions from federal income taxes until 1951. By 1934 there were over 2,000 credit unions operating in the United States, chartered by 35 states and the District of Columbia.

The Federal Credit Union Act of 1934 allowed the states to tax federal credit unions only up to the maximum rates levied on similar domestic banking institutions.

In June 1935, in response to an inquiry from the Farm Credit Administration, which regulated federal credit unions at that time, the Internal Revenue Commissioner ruled that federal credit unions would be granted exemption from federal income tax.

In 1936 legislation was introduced to prohibit state and local taxation of federal credit unions not based on real or tangible property, and to provide credit unions an exemption from federal taxation. The tax provision that passed in 1937 remains unchanged since that time. Section 122 of the Federal Credit Union Act (12 USC Section 1768) reads as follows:

The Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such Federal credit unions shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed—

The arguments in support of the tax exemption were summed up in the 1937 House Committee Report:

Experience with Federal credit unions since the passage of the original [1934] act indicates that the taxation of these organizations in a manner similar to the taxation of domestic banks places a disproportionate and excessive burden on the credit unions. . .As Federal credit unions are mutual or cooperative organizations operated entirely by and for their members, it appears appropriate that local taxation should be levied on the members rather than on the organization itself.

At the same time that Congress provided for the federal credit union tax exemption, it designated federal credit unions as fiscal agents of the United States, required to perform whatever services the Secretary of the Treasury required in connection with the collection of taxes and the lending and repayment of money to the U.S. government (Section 121 of the Federal Credit Union Act, 12 USC Section 1767). When designated, federal credit unions can be depositories of public money, and some credit unions today hold federal tax and loan accounts, typically used by employers to deposit periodic payroll taxes due to the U.S. Treasury. This provision of the Federal Credit Union Act led to the formal designation of federal credit unions as instrumentalities of the United States government. This designation as a federal instrumentality is significant in determining which section of the Code governs federal credit unions' tax-exemption and in exempting federal credit unions from the application of the unrelated business income provisions of the Code.

Federal credit unions are exempt under Section 501(c)(1) of the Internal Revenue Code because they meet the three requirements of that subsection of the Code: They are chartered by Congress (through the authority granted to the National Credit Union Administration); they are federal instrumentalities; and the law they operate under (the Federal Credit Union Act) specifically grants an exemption. National banks are also federal instrumentalities, but they are for-profit institutions and Congress has not included in the National Bank Act a tax exemption for national banks.

Mutual Thrifts' Loss of Tax-Exemption

In 1951, the tax treatment of mutual thrifts and credit unions diverged for a very good reason: mutual thrifts had strayed from their commitment to mutuality, whereas credit unions have remained true to that commitment. The Attorney General's 1917 ruling had continued to provide the tax-exemption for state chartered credit unions until 1951. In 1951 Congress repealed the income tax exemption of mutual savings banks because they competed with taxed institutions *and* because they engaged in widespread proxy voting schemes to control boards. Voting is based on the amount a person has on deposit, not on the basis of one-member-one-vote as is the case with credit unions. This voting system allows a group to control the mutual thrift, and therefore to make business decisions for their own personal pecuniary rewards, not as a not-for-profit organization. The U.S. Treasury stated the following in its 2001 comprehensive report on credit unions:

In 1951, however, Congress removed the thrift tax exemption because these institutions had evolved into commercial bank competitors, and had lost their mutuality, in the sense that the institutions' borrowers and depositors were not necessarily the same individuals.

Although deciding to eliminate the tax-exemption for other mutual financial institutions in 1951, Congress specifically retained the tax-exemption for state chartered credit unions by adding to the list of exempt organizations Section 501(c)(14)(A): "Credit unions without capital stock organized and operated for mutual purposes and without profit." While this Code provision does not specifically reference state chartered credit unions, federal credit unions were exempt from federal income tax since 1937 under Section 501(c)(1), so this subsection only applies to state chartered credit unions.

No credit union issues stock, and therefore no credit union has stockholders. Credit unions have members, called shareholders because of the requirement to purchase a share in the credit union as the indicia of membership *and* ownership. No one can borrow directly from the credit union without becoming a member. Credit unions can only build up capital ("net worth") through earnings retained after covering expenses, including paying members for their savings through dividends. (Credit union dividends are treated by the Internal Revenue Service for reporting and taxing purposes as identical to interest paid by bank customers on their savings.)

The Federal Credit Union Act assures that mutuality is maintained because the Act mandates the membership requirement and that each member of the federal credit union have one vote to elect the credit union's unpaid board of directors, regardless of the amount of savings at the credit union. The standard federal credit union bylaws, issued by the National Credit Union Administration, dictate election procedures in conformance to the Act. In short, credit unions' commitment to mutuality is firmly embedded in the laws governing them.

When, in 1951, Congress determined that mutual savings banks had become competitors with taxed institutions, the thrifts actually accounted for a *greater* share of household savings deposits than banks did. They were indeed significant competitors with banks. Today, in comparison, credit unions represent only a tiny fraction of the combined deposits of credit unions and banking institutions.

Unrelated Business Income Taxes

Not all credit unions are exempt from all federal income taxes. In 1969 Congress extended the unrelated business income tax (UBIT) requirements of Sections 511–514 of the Internal Revenue Code to cover a broad array of otherwise tax-exempt organizations. State chartered credit unions *potentially* became subject to UBIT. Federal credit unions are not subject to UBIT because federal instrumentalities are specifically exempt from Sections 511–514. It is totally logical that federally chartered credit unions are exempt from UBIT because Congress establishes the powers of a federal credit union in the Federal Credit Union Act and has not authorized any activity that it believes is unrelated to the purpose of a credit union. Federal credit unions are not required by the IRS to file the Form 990 that other tax-exempt organizations are required to file. In response to the banking industry's call for 990 filings by all credit unions, we wrote to the Ways and Means Committee in July 2004, explaining why such a filing is not required and not necessary for federal credit unions. State chartered credit unions do file 990 forms, either individually or as part of a group 990 form filed by their state regulator or trade association, as permitted by the Service.

From the start, the application of UBIT to state-chartered credit unions raised some difficult issues that have yet to be addressed satisfactorily by the IRS.

UBIT applies to a trade or business regularly carried on by a state-chartered credit union, where that trade or business is not substantially related to the purpose of the credit union's tax exemption. We believe that the purpose of state-chartered credit unions' federal tax exemption is to enable them to function as not-for-profit cooperatives offering financial services that promote thrift. However, the IRS has never offered its own articulation of the purpose of the exemption. Without that piece of the puzzle, it is very difficult for credit unions to know what products and services are unrelated to their tax—exempt purpose.

To make matters worse, what little guidance the IRS has issued on this subject over the years has been sporadic, isolated, and contradictory. In the 1970s, for instance, the Service issued a small number of private letter rulings indicating that various insurance products were not subject to UBIT. In 1995, however, the IRS issued another private letter ruling that seems to contradict the earlier ones. Of course, even private letter rulings are of limited utility, as they are regarded as applying only to the organization to which the letter is addressed. Credit unions have been left wondering what to do.

We have tried diligently to address the problem with the IRS. In 1997, CUNA and other credit union organizations formally wrote to the IRS, challenging the conclusion of the 1995 private letter ruling and requesting guidance applicable to all credit unions.

The IRS has yet to respond to our 1997 request for guidance. Several years ago, the Service started to audit dozens of credit unions, questioning if they should be filing a Form 990–T, which is required for any tax-exempt organization with more than $1,000 of gross income from unrelated business activities. Numerous activities were cited by the field staff as being *possibly* subject to UBIT; the IRS field staff turned to the central IRS office for guidance. We have been discussing this issue with the Service for some time, and we understand that the IRS hopes to provide some guidance to its *own* staff next year.

UBIT is a complicated area, and we think it is unreasonable to expect any credit union to be filing 990–T forms until adequate, public guidance is issued. The IRS Exempt Organization division recently released a listing of its FY2006 plans, which implies that it has possible problems with some state chartered credit unions complying with the UBIT requirements. We are concerned that the IRS may now be planning to hold credit unions responsible for taxes that they could not have known they owed—and that the IRS has yet to articulate a coherent theory of what is and is not subject to UBIT.

Recent Congressional Reaffirmation of Credit Unions' Tax-Exempt Status

In 1998, Congress overwhelmingly approved the Credit Union Membership Access Act, which reaffirmed the tax treatment of credit unions. CUMAA stated:

The Congress finds the following: (4) Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.

Serving Working America

The Federal Credit Union Act was enacted by Congress during the depths of the Great Depression. The law's preamble said the purpose of the legislation was "to establish a Federal Credit Union System, to establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States."

That fleeting reference to "people of small means" was the only mention of that term in the entire statute. (Many state credit union laws do not mention this term at all.) Bankers cite these few cryptic words to say that credit unions were chartered to serve only people at the low end of the income scale. As the legislative history indicates, however, **Congress created a national system of credit unions to address the credit and savings needs of *working* Americans, allowing them to pool their resources in self-help financial organizations.**

In 1934 basically there were rich people, served by the banks that survived in the 1930's, and everyone else who were at the mercy of loan sharks. As the 1934 Senate report on the federal credit union bill stated, there was a pressing need "to eliminate the loss of buying power which now results from the fact that the masses of the people are obliged to look to high-rate money lenders in time of credit necessity." Credit unions were formed to serve these "masses," and are proud to have 87 million members today. The commercial banking industry didn't seem to decide until the 1960's that it could make a profit off of the everyday financial needs of the typical American consumer.

When he introduced his credit union bill in 1934, Senator Sheppard cited the success of the 2,200 state chartered credit unions: "While these credit unions—are managed by the working people and the farmers who compose them, they have come through 3 years of extreme depression with practically no failures, establishing the finest record ever established by any form of banking in times of similar stress. . . . This bill is offered as a substantial contribution to a better banking system for average city workers and farmers. It would greatly stimulate the spread of a form of cooperative banking, which has met every test of the depression successfully."

Senator Sheppard in his introductory remarks cited the success of state chartered credit unions composed of: postal workers; railroad workers; city employees; telephone workers; members of the National Grange; and the American Legion. Looking at the largest credit unions today, they are based on similar memberships composed of: America's military services; federal, state and local government employees; airline transportation employees; utility company employees; and so forth. The common denominator of the credit union member of the 1930's and the credit union member of the 21st century is he or she is part of working America. Morris Sheppard, Wright Patman and the other members of Congress who advocated in the 1930's the development of a national credit union system would be very proud to see their handiwork today.

Credit union charters based on community, associations or employment existed prior to 1934, and the new Federal Credit Union Act also recognized these various types of charters. However, charters based on employee groups were by far the most viable because they consisted of people who were employed and were the easiest to organize into a critical mass of participation. Therefore, most credit union charters issued in the decades following 1934 were for employee groups. Obviously, the U.S. economy has changed in 70 years. In the 1930's, one in five U.S. workers was employed on farms; today, that ratio has fallen to one in forty. In the 1930's, the service sector accounted for only one-third of the work force; today it represents more than 80% of all workers, many working for small businesses. It was not until the early 1980's—faced with a serious recession, a changing workplace, and the threat to safety and soundness both to individual credit unions and the National Credit Union Share Insurance Fund (created in 1970)—that many credit unions began to change to multiple employee group charters or community charters.

The asset size of a credit union, which is typically a reflection of the number of members a credit union serves, also has never been and should never be the basis for considering the imposition of federal income taxation. Interestingly, Roy Bergengren, a founding father of the U.S. credit union movement, testified to the Senate Banking Committee in 1933 that in some states some credit unions "are now bigger than the average bank in the State."

Serving Member Businesses

Some people are of the mistaken belief that credit unions did not get the authority to offer business loans until the passage of the Credit Union Membership Access Act in 1998. On the contrary, credit unions have offered what we now think of as business loans from their earliest days. In fact, CUMAA *limited* for the first time by statute how much business lending a federally insured credit union can do. Until NCUA issued a member business loan regulation in 1987, the only restriction on business lending by a federal credit union was found in its bylaws.

It was no secret to those involved in passage of the Federal Credit Union Act in 1934 that business loans were commonly made by certain credit unions, depending on their field of membership. Roy Bergengren said to the Senate Banking Committee in 1933 that credit unions promote: "—the public good by developing thrift through the credit unions, solving the short-term credit problems of the worker, *the small business man*, and the farmer, freeing them from the usurious money lenders and teaching sound economic lessons at a time when such teaching is very essential" (emphasis added).

In fact, **the 1934 law said that federal credit unions' purpose was "creating a source of credit for provident *or productive* purposes." This language anticipated that business loans would be made by federal credit unions, since state chartered credit unions had been making business loans since first chartered in 1909.** For instance, here is a Boston advertisement from around 1912:

The Industrial Credit Union encourages borrowing by its members, when it will enable them—(2) To become established in business. *Examples*: The purchase of tools for a mechanic. The giving of sufficient credit to a member to enable him to start a business where he must put out money for wages, bonds, running expenses, etc. The buying for cash of plant, good-will or stock in trade.

Roy Bergengren documented in 1923: A loan for a World War I veteran to start a junk business; a loan to another veteran to buy a truck to fix machines; a loan to a widow to buy stenography equipment; and a loan to a man to buy a variety store in his neighborhood with follow-up loans for improvements and goods. In 1924, in a meeting seeking to organize financial cooperatives, the keynoter said a basic need in obtaining federal legislation is to make loans for "thrifty or productive use; that is, primarily for purposes that will enable borrowers to repay their loans out of the increase of that for which money is spent."

A 1927 study on "Why Workers Borrow: A Study of Four Thousand Credit Union Loans," published by the federal government in its "Monthly Labor Review," found that about 8% of the loans were to "small business men who needed help to tide them over a dull period or to expand when their business seemed to warrant it. Many of the shopkeepers also borrowed in order to make cash payments on stock when they could buy it more cheaply that way."

In responding to NCUA's 1986 proposal to impose restrictions on business lending by all federally insured credit, those credit unions making business loans provided many examples. (Of course, then as now, only certain credit unions engage in business lending, depending on their fields of membership.) Here are a couple of examples from the mid-1980's of the types of business loans being made by credit unions at that time:

- Northeast Community Federal Credit Union in San Francisco: Loans to immigrants to open small businesses in the changing "Tenderloin" area of the city.
- Santa Cruz Community Credit Union in California: Between its founding in 1977 and in 1985, approximately $12 million of its $20 million in loans were made for business purposes (many for less than $25,000). Example: A business loan to a small local newspaper for capital expansion.

So contrary to any belief that Congress intended that credit unions be precluded from making business loans to its members as a condition of being tax-exempt organizations, **the record clearly shows that for 25 years prior to the enactment of the Federal Credit Union Act in 1934 and for the 70 years after its enactment, certain federal and state chartered credit unions have been an important resource for member business loans**.

Credit Unions Are Unique Among Cooperatives

Credit unions' earnings are the pot of money that would be taxed at the end of the year. Taxation would erode what credit unions could build as a cushion and, depending on economic conditions, could even undermine maintaining the net worth required by statute. This cushion not only protects the credit union itself from future challenges, but also protects the National Credit Union Share Insurance Fund. Because the full faith and credit of the United States stands behind the NCUSIF, ultimately the American taxpayers pay if serious problems arise in the financial market place. This is what happened when the federal government had to spend billions of dollars to clean up the savings and loan industry debacle of the 1980's.

Although both the NCUSIF and the Federal Deposit Insurance Corporation (which insures bank deposits) are backed by the U.S. government, only the NCUSIF requires the institutions it insures to deposit an amount equal to 1% of their federally insured funds with the U.S. Treasury *and* to replenish the 1% from their retained earnings if financial troubles throughout the system require large NCUSIF payouts. As credit unions grow, they are required to contribute more to maintain their 1% deposit in the NCUSIF, and the added dollars count toward the federal government's deficit reduction. Therefore, the unique NCUSIF capitalization system relies on well-capitalized credit unions that can transfer funds to the NCUSIF in case of systemic problems. The FDIC insurance program has no such safety net before it turns to the Congress for appropriated funds.

Other cooperatives don't have the full faith and credit of the United States ultimately standing behind their ventures. Fortunately, credit unions by their very nature—volunteer-lead, non-stock cooperatives—are conservatively run because there is no personal pecuniary interest in taking risks with other people's money, a key credit union distinction from both stock and mutual banks. It would be counterproductive to tax credit unions, thereby encouraging them to run up expenses and otherwise reducing their net income subject to tax.

Although estimates of taxing credit union indicate that that about $1.5 billion a year would be collected by the federal government, these estimates apparently don't take into account fundamental changes that inevitably would be made in credit union operations if taxed. For example, there are 150,000 people who volunteer their services by serving on credit union boards and committees to further the not-for-profit mission of their credit unions. The Federal Credit Union Act prohibits all but one volunteer from being compensated, and for the few federal credit unions that provide any "compensation," it is nominal. Some states allow board compensation, but again any compensation received by board members in those states typically is quite nominal, if provided at all.

Since any compensation paid by a taxable organization is a deductible expense, the question would quickly arise if a credit union were taxed, "Why not pay people who serve on boards of directors, supervisory committees, credit committees, and other committees of the credit union?" This would lower the taxes due, but also undermine a credit union's fundamental philosophy, "People Helping People." And anyone serving in any position for other than nominal compensation is certainly driven by different motives than those who are volunteering their services.

ARE CREDIT UNIONS SERVING THEIR INTENDED GOALS?

Treasury and Congressional Findings: CUs Fulfill Their Purpose

The U.S. Department of the Treasury has conducted several detailed studies of credit unions in the last eight years. These objective studies, which were requested by Congress, are exhaustive and present detailed analyses of the credit union system. The studies portray credit unions generally as robust institutions with a specialized structure serving identifiable groups of members.

One of the most comprehensive studies, "Comparing Credit Unions With Other Depository Institutions," was issued in 2001. (The link to the study is: http://www.treas.gov/press/releases/reports/report30702.doc.)

In that study, the Treasury Department was asked to analyze, among other issues, the "potential effects" of imposing federal tax laws on credit unions in the same manner as they are applied to banks and other financial institutions.

As part of its review, the study examined the history of the tax treatment of credit unions, including Congress' rationale for the credit union exemption. The Treasury Department concluded (on page 28 of the report):

Thus, the tax exemption was based primarily on the organizational form of credit unions—.

The study observed that credit unions have grown larger in recent years and have expanded the list of products and services they offer their members. Nonetheless, drawing on the Credit Union Membership Access Act (CUMAA, P.L. 105–219) and a 1997 Treasury report, "Credit Unions," the study concluded, remain "clearly distinguishable from" banks and thrifts in their organizational and operational characteristics. Such characteristics are:

- Credit unions are member-owned and each is entitled to one vote in selecting the credit union's board and in other decisions.
- Credit unions do not issue capital stock but create net worth by retaining earnings.
- While some credit unions have the legal authority to have paid employees or other paid directors serve on their boards, credit unions depend on volunteers elected by their members to serve as directors.
- Credit unions are not-for-profit and all earnings are either retained as net worth or returned to the members in the form of lower loan rates, dividends or interest on savings, bonus dividends or similar uses.
- Credit unions may "only accept as members those individuals identified in a credit union's articulated field of membership."

The study noted that while other types of institutions may exhibit one or more of these characteristics, only credit unions exhibit all five together.

Section Two of the congressional findings of CUMAA—legislation enacted in 1998 to overturn the Supreme Court's ruling on field of membership—lists these same attributes as the distinguishing factors a credit union embodies.

The CUMAA congressional findings also concluded that credit unions are exempt from taxation because of these characteristics and because credit unions have "the specified mission of meeting the credit and savings needs of consumers, especially (but not only,) (*parenthesis added*) persons of modest means".

Congress further found, after probing hearings in the House Financial Services Committee and Senate Banking Committee, that the credit union movement in the United States began as a "cooperative effort to serve the productive and provident credit needs of individuals of modest means."

Congress further stated in its findings that "Credit unions continue to fulfill this public purpose. . . ."

Service To All Members, Including Those of Modest Means, Is the Hallmark of Credit Unions

I began this statement by listing some of my own credit union's services. Credit unions all across the country undertake considerable efforts to serve the financial needs of individuals of modest means. These programs include pro-consumer check cashing and other services that provide alternatives to payday lending; beneficial savings plans; financial counseling; financial management workshops; special home mortgage and other tailored lending programs; and partnerships with community organizations that serve low and moderate income families.

These initiatives are in addition to the favorable loan and savings programs credit unions routinely offer their members. Many credit unions will open a share certificate or savings account for $100 or less and will grant a member a loan for a similar low amount—a practice that is virtually unheard of at other financial institutions. In addition, a number of credit unions provide technical support, training, equipment, financial or other assistance to credit unions that serve predominantly low and moderate income areas.

Throughout most of their history, credit unions have actually been hamstrung in their efforts to serve members of modest means because field of membership rules generally restricted eligibility to occupational groups. It is only in the past couple of decades that smaller employee groups because eligible for credit union service, and even more recently that community charters became relatively accessible for credit unions. Then just five years ago, the National Credit Union Administration adopted an expedited program known as Access Across America to permit federal credit unions to add underserved areas to their fields of membership. Since the beginning of 2001, over 92 million potential members from underserved areas have been added to credit union fields of membership. Credit unions acknowledge it will take some time to reach out to and serve members in these communities. However, in the three years ending December 2003, credit unions that added such underserved areas experienced membership growth over three times that of other credit unions (17.4% vs. 5.2% over the three year period.)

The study, "Who Uses Credit Unions," (Lee, Jinkook, University of Georgia and Kelly, Jr., William A., University of Wisconsin-Madison) which was updated in 2004, clearly shows that households of modest means, as well as households in other income categories, rely on credit unions to meet their financial needs. The study was based on the Survey of Consumer Finance that is sponsored every three years by the Federal Reserve Board.

Among other things, the study reviewed the median net financial wealth of households, which it defined as total financial wealth less credit card and other unsecured debt. This included deposit accounts, mutual funds, securities accounts, savings, insurance, cash and other financial assets.

The study found that households that use banks exclusively have a median net financial wealth 2.7 times as much as households that use a credit union exclusively. The median net financial wealth for a credit union household was $7,900. The average annual income for households that use credit unions only for their financial needs was $42,662 compared to $76,923 for households using banks only. Income could include wages, salaries, interest income, unemployment compensation, child support, alimony, welfare assistance and pension income.

The study's findings squarely refute the charge that bank customers are less affluent than credit union members. "Households using a bank and not a credit union have higher incomes and wealth than households that use only a credit union," the study points out.

The methodology of the study is significant because unlike other studies, it reviewed consumer financial institution affiliations based on five categories: households that use banks only and are not members of a credit union (56% of the households); households that use both banks and credit unions, but primarily use a bank (16%); households that use both banks and credit unions but primarily use a credit union (12%); households that use a credit union only (8%); and those that use neither banks nor credit unions (6%).

The use of this model allowed the study to overcome the deficiencies in other studies on credit union membership that compare credit union members with non-members or compare credit union members with bank customers.

The study also found:

At the top income brackets, we see a very high use of banks only, which suggests that banks are particularly successful in gaining the entire business of these households. However, households in the top income brackets seldom use a credit union only. For example, in the $100,000–$200,000 income category, households are 23 times more likely to use only a bank than only a credit union and households with income over $200,000 are 68 times more likely to use only a bank than only a credit union. . . . Further among those that use a bank only, median net financial wealth is higher than among households that use a credit union.

The latest report from the Federal Reserve Board on Home Mortgage Disclosure Act (HMDA) data (December 2004) also demonstrates credit unions' service to those of modest means.

The HMDA data set provides a wealth of information on mortgages by type of loan (such as refinancing and conventional loans) and the socioeconomic characteristics of the applicant. The data provides information on loan approvals and denials. It also shows the proportion of approved loans that were actually granted.

The HMDA data over the past three years, ending in 2004, shows:

- A rising proportion of mortgage loans originated by credit unions are to low-to-moderate income (LMI) borrowers (those whose household income is at 80% of median or less).
- As a result, in 2003 and 2004, a greater proportion of credit union mortgage loans were made to LMI borrowers than at other lenders.

PROPORTIONS OF MORTGAGES ORIGINATED TO LMI BORROWERS

	2002	2003	2004
Credit Unions	24.3%	25.4%	27.6%
All Other Lenders	26.2%	25.4%	26.6%
CU—Others	−1.9%	0.1%	1.0%

This is firm evidence that credit unions are taking advantage of greater opportunities to serve LMI members and disproportionately serve LMI borrowers.

In addition to the core fact that credit unions make a greater portion of their loans to LMI borrowers than other lenders do, there are a number of other indicators in the HMDA data that demonstrate greater credit union service to LMI borrowers. While credit unions serve a greater proportion of LMI borrowers than do other lenders, they also provide more favorable treatment to LMI borrowers compared to their treatment from other lenders.

Credit unions understand and appreciate that they have a special purpose in helping to meet the financial needs of individuals of modest means. Not only is the regulatory environment more conductive to outreach, but also CUMAA facilitates credit union expansions to serve the underserved. Key data already indicate credit unions provide important service to individuals ignored or shunned by other institutions and there is every indication that future data will reflect the ever growing efforts of credit unions to serve those of modest means.

In fact, just three days ago, here in Washington a group of credit unions announced a near billion-dollar new mortgage program targeted specifically at our lower income members. This program has been under development for the past year. Under the program, which we are calling Home Loan Payment Relief (HLPR, pronounced "helper") credit unions will make loans to borrowers with incomes at or below the local area median at rates that are a full percentage point below market for the first three years of the loan. After that, therates will adjust to market on anadjustable basis, with yearly limits on the increase of 1% and a lifetime cap of 5%.

With the initial rate discount, credit unions are essentially giving up their normal net income from these loans. The program will enable thousand of modest means credit members to buy their first house, without exposing them to the severe risks of such exotic loans as short-term adjustable interest only loans. We expect this program to grow to over $10 billion over the next several years.

Field of Membership as a Defining Characteristic of Credit Unions

Since their inception, credit unions have had limitations on whom they could serve. Historically, these limitations had nothing to do wit the tax exemption. But this is an appropriate occasion to address some issues raised by the banking industry about field of membership.

A credit union's field of membership represents the persons, organizations and other entities to whom and which a credit union may legally provide its services. At the federal level, a credit union's field of membership may be occupational—based on employment by the same or related businesses; associational—based on membership in the same association; multiple group—comprised of more than one group; or based on one or more communities. Each group within a credit union must have a common bond, which is the characteristic that distinguishes the group from the general public. There are a number of other statutory and regulatory restrictions that apply, regardless of the type of field of membership a credit union chooses.

Some would have this Committee believe that field of memberships have become so broad that virtually anyone can join any credit union. That is far from the case. As a resident of El Paso, I cannot join a credit union with a community charter in New York, regardless of how large that community might be. As a credit union CEO, I cannot join Navy Federal Credit Union, and my colleague from Navy Federal cannot join GECU.

At the same time, comments from then NCUA Board Chairman Dennis Dollar help illustrate why reasonable field of membership expansions and the capability to add new groups is so essential to credit unions.

We have lost more credit unions, and particularly small credit unions, because of lack of diversification of field of membership than any other reason. If we are going to be effective with risk-management in our credit unions, if we are going to be effective enabling credit unions to diversify their risk to where the closing or downsizing of a sponsor does not take away what would otherwise be a strong and functioning credit union, we must have diversification in our field of membership within the bounds of what the law allows.

Consistent with the bankers' record of attack, several issues remain the subject of their criticism. One relates to the misconception that CUMAA only permits groups of 3,000 or less to be added to an existing credit union. This is inaccurate.

Groups with 3,000 or more members are eligible to join an existing credit union if the NCUA determines in writing in accordance with guidelines and regulations that the group would not be financially viable and is unlikely to succeed as a new single common bond credit union. (S. Rept. 105–193)

Another issue is how NCUA views "local" as the term applies to the area a community credit union may serve. The fact remains that Congress specifically authorized NCUA to prescribe a regulation defining "well-defined local community" for credit unions that seek to serve a community. NCUA was given this task because it has the relevant expertise developed over decades of implementing field of membership issues.

Community credit unions must meet all legal requirements, including being well-defined by specific geographic boundaries. Under NCUA's policies, "If NCUA does not find sufficient evidence of community interaction and common interests—additional documentation will be required" in order for NCUA to assess whether the community exists and may be rejected if all requirements are not met.

Additionally, community credit unions must develop a detailed and practical business plan. The plan must "focus on the accomplishment of the unique financial and operational factors of a community charter. Community credit unions will be expected to regularly review and to follow—the business plan" which is also subject to review by NCUA examiners.

As NCUA Board Chairman JoAnn Johnson stated, NCUA follows three standards when implementing policy: it must be thoroughly consistent with CUMAA; it must comply with recognized and historical safety and soundness standards; and it must be implemented with a minim amount of paperwork and unnecessary regulatory burden.

In responding to Congress's directive to prescribe requirements for "well-defined local communities" that is exactly what NCUA has done.

As stated by then NCUA board member Debbie Matz when the changes to the agency's field of membership policy were adopted:

I am cognizant of the fact that the statute requires that a proposed community credit union must comprise "a local community, neighborhood, or rural district." I have given a great deal of thought to the concept of "local community" and what that really means in the year 2003. I have concluded that times have changed and so has the concept of local community. Years ago this might have been the neighborhood in which one lived and worked—perhaps a few city blocks or a town. In this age of advanced communications, accessible public transportation and highway systems and regional shopping malls and business centers, the larger community charters permitted in this regulation are not, in my opinion, inconsistent with the statutory requirements.

Further, I have concluded that size, in and of itself, should not be a factor in determining the validity of a field of membership. It is a commitment to the credit union philosophy of people helping people. This is what credit unions are all about. I believe that one of the distinguishing characteristics of credit unions is the wide array of affordable financial services they offer: $200 loans to a family to prevent their electricity from being turned off; risk-based lending as an alternative to payday loans; branches in very-low-income neighborhoods; and world-class financial literacy programs. Under this rule, the size of a community is no longer the primary focus. Our attention would shift to the real issue—how the credit union would serve everyone in its field of membership.

Perhaps most importantly, larger fields of membership will permit more people to join a credit union and I think that is a really good thing. This (change) will permit credit unions to make their services available to some of the 56 million people who do not have accounts in insured financial institutions.

Despite rhetoric to the contrary, credit union membership has demonstrable limitations. Nonetheless, as recognized by GAO, the Treasury and others, CUMAA contains a number of provisions that authorize credit union membership growth and expansion. NCUA's obligation as the regulatory agency charged with implementing these provisions is to permit credit unions to utilize the full extent of the field of membership authority granted to them by Congress, which the agency seeks to do. Any less from NCUA would be abrogating the responsibilities bestowed on it by Congress.

None of this has the slightest bearing on the tax exemption issue.

Credit Union Member Business Lending Meets A Need that is Not Being Fulfilled Elsewhere

Based on data from the Small Business Administration (SBA) and elsewhere, credit unions that engage in member business lending often fulfill borrowing needs that are not being met by other institutions. Nonetheless, credit union opponents often focus their criticisms on member business lending activities.

Under CUMAA, the Department of the Treasury was requested to review a number of issues relating to credit unions' member business lending. This included examining the extent to which member business lending helps to meet the financial needs of low and moderate income individuals. The study also considered whether credit unions that engage in member business lending have a competitive advantage over other financial institutions.

In January 2001, the Treasury issued its report, which indicated then, as is the case now, that **member business lending is consistent with the purpose of credit unions**; it **does not represent the competitive concern that banks claim** it does; and it is an activity for credit unions that is **consistent with safety and soundness**.

Under NCUA rules and statutory requirements, a member business loan (MBL) is a loan, line of credit, or letter of credit under which the borrower uses the proceeds for commercial, corporate, business investment property or venture, or agricultural purposes. Loans fully secured by 1–4 family residences and loans the total of which to an individual are less than $50,000 are excluded. As part of CUMAA, credit unions must limit their MBLs to the lesser of 1.75 times net worth or 12.25 percent of total assets. These limits were first imposed in 1998.

In its study, the Treasury found that 25 percent of the credit union member business loans were made to members with household incomes of less than $30,000. Another 20 percent of credit union member business loans were to households with incomes between $30,000 and $50,000. The study also indicated that member business lending does not pose a material risk to the National Credit Union Share Insurance Fund.

The Treasury added:

"Business lending is a niche market for credit unions. Overall, credit unions are not a threat to the viability and profitability of other insured depository institutions."

A major reason for the Treasury's conclusion is that credit unions share of business loans is less than 1 percent of the market. Only about 1,780 credit unions make member business loans, an increase of about 170 credit unions from 1995. Also, the average size member business loan at a credit union is around $155,000. A 2002 survey conducted by the American Bankers Association showed that only 4% of commercial banks viewed credit unions as their primary competitors in business lending or other business financial services.

"Banks still dominate SBA lending," the *American Banker* newspaper reported on October 27, 2005. "More than a dozen banking companies make more loans on their own than all credit unions combined in fiscal 2005. Bank of America Corp., for example, made nearly 12,000 worth $413 million."

Citing the need for lenders to make more, small business loans, the SBA has encouraged credit unions to participate in its 7(a) lending program. Currently 103 credit unions make loans through that program; the average loan size is around $109,000.

Treasury Secretary John Snow has also encouraged credit unions to provide member business loans. In February 2004, the Secretary appeared before the CUNA Governmental Affairs Conference and commended credit unions:

Small business is at the foundation of this great economy, and credit unions have been there for entrepreneurs when they needed you the most. As of last year, credit unions were welcomed into the SBA lending programs, and I hope that has helped out both you and America's entrepreneurs as much as this Administration hoped it would. You know as well as I do: small business is where the jobs come from. We estimate that between two-thirds and three-quarters of recent net new jobs are coming from that sector. That's why we want to make small business tax cuts permanent, and that's why I want to commend the credit union community for financing America's hard-working small-business owners!

In February of this year, the Secretary reiterated his support:

You do good work. Loans to small business, home mortgages, financial education and fighting the financial war on terror—each one of these efforts is critical to our country's economic health and strength, and I applaud you for doing good while you do business. We don't want less small business lending.

Yet, that is exactly what banker groups envision for credit unions, making fewer member business loans. If that happens, it won't just be credit unions and their members that are harmed, but the small business community and the economy.

USE OF THE TAX BENEFIT

There are significant financial benefits to members. The nation's 87 million credit union members benefit by $6.3 billion a year as a result of paying fewer and lower fees and lower loan rates and earning higher rates on deposits compared to banking institutions. This $6.3 billion is not retained by just a few large stockholders. Instead it is distributed across all 87 million members based on their usage of the credit union. In fact, relatively more of the benefit accrues to lower income members than would be explained by their volume of business at the credit union because credit union pricing tends to be friendlier to lower balance accounts than at banks and alternative financial institutions. For example, in 2004, considering a basic checking account, 79% of credit unions had a no fee account compared to only 32% of banks. Further, at those credit unions charging a fee, the monthly average was less than half the average fee charged by banks, $4.21 compared to $8.56. Finally, the average minimum balance required to avoid the fee at a credit union was $486, less than a third of the average fee-avoiding minimum at banks of $1,645. Clearly, lower income members receive significant benefits from their access to credit union service.

There are also significant financial benefits to consumers that are not members of credit unions. Based on the work of Professors Robert Tokle of Idaho State University and Robert Feinberg of American University, and also based on research from the Board of Governors of the Federal Reserve, bank customers benefit to the tune of at about $4.3 billion a year. This is the result of lower loan rates and higher deposit rates at banks as a result of the existence of credit unions. The effect of credit union presence on bank fees has not been estimated, but undoubtedly would add to the $4.3 billion annual benefit to bank customers.

Although bank customers benefit because of the existence of credit unions, other financial institutions continue to thrive in the presence of credit unions. The FDIC recently reported that banks recorded record profits for the fourth year in a row.[1] Aggregate bank return on assets (ROA) has exceeded 1% for the past 12 years, averaging 1.23%. And credit unions are only growing marginally faster than banks. In the decade ending in 2004, total banking institution assets grew at a compound annual rate of 7.25% compared to 8.4% for credit unions. Credit unions now account for 6.2% of the combined assets of all depository institutions. At the growth rates of the past decade, it will take until the year 2053 for the credit union share to climb to just 10%.

The health of the banking industry over the past decade has not been confined to just large banks. In a 2003 conference, Federal Reserve Gov. Mark Olson said: "The year that just ended was one of record profits for the industry as a whole, and for community banks in particular—Community banking has a long history of strength and success and a bright future. The past year was a good one for community banks. Once again the vitality and adaptability of the community banking franchise were amply demonstrated."[2] Two Federal Reserve economists have recently described the strong performance of the nation's smaller banks. They found that "small banks have grown considerably more rapidly than large banks and have tended to meet or exceed them in some measures of profitability."[3]

In total then, bank customers and credit union members benefit to the tune of at least $10.6 billion a year. That is seven times the amount of revenue that would result from the taxation of credit unions. The tax exemption is leveraged in this way because of the cooperative structure of credit unions. When comparing banks to credit unions, the amount that banks pay in dividends to stockholders is more significant than is the tax exemption. Further, credit unions pay very little compensation to directors, with the savings passed on to members. Finally, credit unions' ratios for expenses and loan losses compare very favorably to similarly sized banks.

Society benefits in a number of ways from the tax exemption of the nation's notfor profit credit unions. Both members and nonmembers benefit from the existence of credit unions. Part of that benefit stems from having a sector of the financial services industry with the provision of service to the less fortunate in our society as an integral part of their strategic mission. This benefits the nation's modest means households both directly through credit union services and indirectly by serving as an example to other financial service providers. In addition, the taxpayer is provided considerable protection from risk of loss to the National Credit Union Share Insurance Fund by virtue of the tax exemption. Credit unions also provide an important source of loans to America's small businesses at a time when credit from other sources is becoming less available.

Removing the tax exemption of credit unions would so change the structure of the industry that within a few years, most credit unions would either have become banks or would be operating very much like banks. That would result in a significant loss of benefits to the nation's 87 million credit union members.

[1] Federal Deposit Insurance Corporation, *Quarterly Banking Profile, Fourth Quarter 2004.*

[2] Comments before the 2003 Chicago Federal Reserve Bank Conference: Whither the Community Bank?

[3] William F. Bassett and Thomas F. Brady. *The Economic Performance of Small Banks, 1985–2000.* Federal Reserve Bulletin, November 2001.

Credit union members benefit both financially and non-financially by virtue of their membership in a credit union. In terms of non-financial benefits, they have the opportunity to belong to and participate in a democratically controlled financial cooperative. Further, they may volunteer to participate in the governance of their financial institution. Crucial to credit unions is the control exerted by the over 150,000 volunteers who serve on boards and committees. Credit unions are also known for offering consumer education and financial counseling services that would be threatened under taxation.

Evidence of the consistently strong level of member focus at credit unions is found in the results of the annual *American Banker* newspaper survey of financial institution customers. Credit union members have for 21 years in a row given credit unions higher satisfaction ratings than bank customers give banks. The cooperative structure really does make a difference.

The tax exemption also serves to protect taxpayers from losses to the share insurance fund. There are two important connections between the stability of NCUSIF and credit unions' tax exemption. First, the primary buffer for a deposit insurance system is the capital or net worth maintained in insured institutions. Because credit unions have no access to capital markets, their only source of capital is the retention of earnings. A tax on net income would thus disincent credit unions from retaining earnings, weakening protection for the NCUSIF. In fact, the cost to the taxpayer of FSLIC's losses far exceeded the total taxes paid by FSLIC insured institutions prior to FSLIC's failure.

Second, as cooperatives, credit unions have a systemic inclination to avoid risky activities. Kane and Hendershott have shown that the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.[4] This is an especially useful trait for federally insured depository institutions.

Credit unions have a long history of providing business loans to their members, although such loans represent a small portion of the portfolio for most credit unions. However, at a time when research published by the Small Business Administration finds that consolidation in the banking industry is reducing credit access for small business, the credit access provided by credit unions is even more important.

Society benefits in a number of ways from the existence of cooperative, not-for-profit credit unions. These benefits would gradually disappear were credit unions subject to federal income tax. Credit union regulation, which is much more restrictive than that for other financial institutions, includes: limits on who the credit union can serve, limits on business lending, lack of access to capital markets, etc. The tax exemption is the incentive that encourages credit union CEOs and boards to continue to operate as credit unions rather than throwing off the restrictions by converting to a bank charter. Such conversions would only limit the range of choices available to America's consumers, especially those of modest means.

CHANGES IN THE INDUSTRY HAVE NOT COMPROMISED JUSTIFICATION OF RETAINING THE TAX EXEMPT STATUS

Credit unions have undergone changes similar to other industries over time. With new technology, the advent of new products and services, credit union members have demanded that their credit unions provide them with access to all the benefits of a modern financial service provider. Credit union membership trends have changed during this time as well. Historically, credit unions were employer based, but with changes in the economy and the closure of many plants, credit unions found ways to continue serving their members, most recently by converting to geographically based memberships that the Federal Credit Union Act has made possible since 1934. But one thing has remained constant—the structure of a credit union and its intense focus on providing its members a not-for-profit alternative with personal service.

Credit Union Products and Services Remain Comparatively Restricted

As member owned institutions, credit unions endeavor to offer products and services that their members need and want. And as technology results in more and better offerings, credit unions must respond to meet their members' demands, so long as they permissible by law and regulation.

Over the years, NCUA, like the bank and thrift regulators, has on occasion amended its regulations to permit credit unions more flexibility to serve their members better. For example, in 2001 NCUA included in its rules a list of activities that

[4] Edward Kane and Robert Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers Journal of Banking and Finance*, 20(September, 1996), pp.1305–1327.

federal credit unions may engage in that are incidental to their authority to operate as a credit union. Such activities encompass electronic financial services and loan-related products. While some have sought to portray the rule change as too liberal, in essence the incidental powers rule codified activities that NCUA had already permitted credit unions to engage in through prior legal opinion letters.

While NCUA has made incremental changes to the list of permissible activities for credit unions, Congress has not considered any comprehensive modernization of the Federal Credit Union Act in over 70 years. (CUMAA, passed in 1998, as previously indicated, was a response to efforts to correct a field of membership problem and resulted in imposing new, burdensome regulations on credit unions.) By contrast, it is fair to note that the sweeping new authority Congress granted the banking system when it adopted the Gramm-Leach Bliley Act in 1999 does not apply to credit unions, with the exception of the privacy provisions. Under that Act, among other things, affiliations between banks, securities firms and insurance companies are facilitated. In addition, financial holding companies are authorized to engage in a range of activities, including any activity that the Federal Reserve Board determines is financial in nature or incidental to financial activities. Banks are permitted to own or control a financial subsidiary that engages in activities that banks may not engage in directly, and they may underwrite and deal in municipal revenue bonds. Further, the Act authorized a number of securities activities for banks including statutory exemptions from broker/dealer requirements and investment advisory requirements.

Even without Gramm-Leach-Bliley, credit unions lag far behind banks in the kinds of activities in which they can engage, notwithstanding the fact that credit unions may offer additional services to their membership through credit union service organizations (Credit unions may loan up to 1% of their assets to a CUSO or invest up to 1% of assets in such organizations.) The 2001 Treasury study comparing credit unions with banks makes it clear credit unions face more operational restrictions than other institutions.

In general, federal credit unions have more limited powers than national banks and federal savings associations. Most notably, federal credit unions face stricter limitations on their commercial lending and securities activities. In addition, a usury ceiling prevents them from charging more than 18 percent on any loan, and the term of many types of loans may not extend beyond 12 years.

The Treasury notes a number of activities that are not permissible for credit unions but are allowed for banks. These include the offering of trust accounts, the purchase or sale of derivatives, investments in corporate debt securities and other activities. (Unlike banks, credit unions' investments are very limited and include government and agency securities, along with certain insurances of government-sponsored enterprises. Credit unions with net worth of 9% have authority to invest in certain mortgage-related securities.)

One of the harshest limitations on credit unions is the ceiling on their member business lending, which is set at the lesser of 1.75 times net worth or 12.25 percent of total assets. National banks have no specific restrictions on commercial lending and thrifts may make commercial loans up to 20% of their total assets.

Credit unions also come under more stringent core net worth (capital) requirements than are placed on banks. As required by statute, credit unions must maintain net worth levels that are actually spelled out in the law. Banks also have core capital requirements, but they are set by regulation, which is easier to change than statutory requirements. In addition, credit unions sustain core net worth that is a full two percentage points higher than the core capital required of banks.

Indeed, the net worth, lending, and other significant restrictions under which credit unions operate are the impetus for the credit union provisions in the Financial Services Regulatory Relief Act, HR 3505, and the Credit Union Regulatory Improvements Act, HR 2317, which are currently pending in the House.

There is no question that while credit unions may offer products and services provided by banks and thrifts in response to their members' needs, credit unions operate under serious constraints. As concluded by the Treasury:

Federal credit unions generally operate within the same legal framework as other federally insured depository institutions. Most differences between credit unions and other depository institutions derive from the structure of credit unions. Credit unions have fewer powers available to them than do banks and thrifts.

A Credit Union's Size Does Not Affect Its Mission

Some have suggested that the nation's very largest credit unions are in some sense no longer true credit unions, that they no longer live up to what Congress originally intended credit unions to be. They go on to argue that therefore large credit unions should no longer be tax-exempt. Yet, these "large" credit unions continue to promote thrift and to provide a source of credit for provident or productive purposes. How many members a credit union has, or how many loans it provides does not affect the core characteristics of a credit union, or the real reasons for credit union's tax exemption. Further, large credit unions today fully live up to what Congress had in mind when it originally created the federal credit union charter and later granted the credit union tax exemption. It should also be remembered that a "large" credit union would still be modest sized by bank standards, and that the nation's three largest banking institutions *each* is larger than the entire credit union movement.

None of the core characteristics of credit unions or rationales for credit unions' tax exemption has anything to do with credit union size, field of membership restrictions, the range of services offered, or the extent to which credit unions might not compete with other financial institutions. Instead, they have everything to do with the cooperative structure of credit unions and their mission of providing affordable services to American households, especially those of modest means.

Credit unions are all about their members. Today credit unions serve 87 million members with affordable financial services. Twenty one million of those members belong to the one hundred credit unions with assets over $1 billion. There is no relation between the size of an institution and the absence or presence of reasons to justify the tax exemption. Large credit unions are democratically controlled, not-for-profit cooperatives in every way that smaller credit unions are. The boards of directors of large credit unions are composed of volunteers just as they are at small credit unions. A large credit union may be more likely to offer a broader array of services, and to be a greater presence in a local community. However, neither factor makes it less a cooperative than a smaller credit union. No one suggests that as soon as the congregation of a church, synagogue or mosque exceeds a certain size, it should no longer be tax exempt. Likewise, it would be ludicrous to say the American Heart Association should lose its tax exemption simply because of its size, while a small local charity should not.

Because of their size and efficiency, large credit unions are often more able to provide the benefits of the cooperative to members, such as lower loan rates and fees and higher dividend rates. Larger credit unions are also more able to offer special programs benefiting low- and moderate-income households. In a survey conducted in 2002, when asked how many of up to 18 services geared to low/mod income households they offered, only 6% of credit unions with assets below $20 million offered at least half of the services. Fully 42% of credit unions with assets over $500 million offered that many of the services. Large credit unions are also more likely than small credit unions to participate in outreach activities to attract low/mod income members, and to have added underserved areas to their fields of membership under NCUA's Access Across America program.

I have already described how my own large credit union fulfills its mission. Here are some examples of what other large credit unions do today:

Navy Federal Credit Union, the nation's largest with two and a half million members and $25 billion in assets, is the epitome of a not-for-profit financial cooperative organized to provide its members with low-cost financial services. It is guided by an unpaid, volunteer, member-elected Board or Directors (one member, one vote.) Navy Federal serves most military and civilian personnel of the Navy and Marine Corps and their families, including almost 400,000 young active duty military personnel of modest means. Members can open a share account with only $5, and the account has no monthly fees, minimum balance requirement, and earns dividends. The credit union operates 108 field offices around the world, from Keflavik, Iceland to Guantanamo Bay, Cuba, to Diego Garcia in the Indian Ocean to Bahrain. Half of the overseas offices operate at a loss, but they are maintained in order to serve military personnel on overseas deployments.

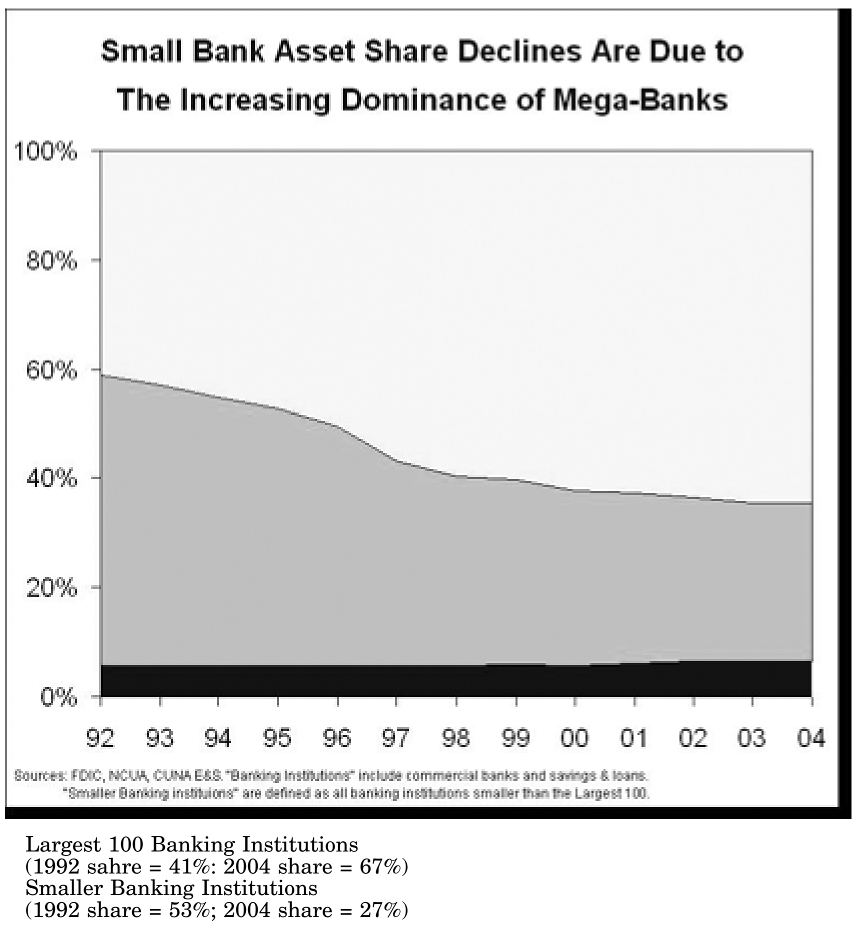
San Antonio Federal Credit Union (230,000 members and $1.8 billion in assets) is a pioneer in financing manufactured housing for members with limited incomes. For many Americans, high quality manufactured housing is a cost effect alternative to the escalating costs of traditional site built homes. Manufactured housing must meet manufacturing standards that meet or often exceed requirements of some local codes. Since entering the manufactured housing finance market in 2002, San Antonio Federal Credit Union has made over 3,000 high quality portfolio loans for this affordable housing. The average loan size is about $50,000. The credit union is also developing the infrastructure to assist other credit unions around the country to serve this market.

Despite the protestations of community bankers, as described above, credit unions are not unfair competitors to banks, and credit unions are not eroding their market share. Further, the share of total depository institution assets held by community and smaller regional banks (all but the top 100 banking institutions in the U.S.)

has indeed plummeted from 53% in 1992 to 27% in 2004. However, over the same period, the share of credit unions has remained stable at about 6%. It is the largest 100 banks (larger regionals, super regionals, and money center banks) that have taken the market share, from 41% in 1992 to 67% in 2004. This is shown in the accompanying chart.

If credit unions had such an "unfair" advantage over banks, one can wonder rhetorically why we have not seen a wholesale conversion from bank to credit union charters. The reason no commercial bank has converted to a credit union is that doing so would expose them to democratic ownership and control, would likely cause banker salaries to decline dramatically, and would force the institutions to adhere to a much more restrictive regulatory regime.

Finally, it is disappointing but not surprising that in all their protestations about the tax treatment of credit unions the banking organizations fail to mention the growing role of Subchapter S banks. Over 2,100 banks have adopted the Sub S form of tax treatment since 1997. While Subchapter S status is not the same as a tax exemption, it results in significant loss of government revenue. The direct cost to the federal government from banking institution Sub S elections is estimated to be $790 million in lost revenue in 2004, and the total will only grow as banks continue to try to expand Sub S eligibility. In fact, it is estimated that the total cost to the Treasury for Sub S election will exceed the estimated cost of the credit union tax exemption within a few years. We believe that the Committee may wish to investigate Subchapter S election, as there appears to be absolutely no functional difference between a Sub S and a Sub C corporation to justify different tax treatment.



Largest 100 Banking Institutions
(1992 sahre = 41%: 2004 share = 67%)
Smaller Banking Institutions
(1992 share = 53%; 2004 share = 27%)

CONCLUSION

Mr. Chairman, it is clear that credit unions play a powerful role in our economy. Credit unions serve people of all walks of life at all economic levels. Credit unions provide the public with a not-for-profit, cooperative alternative to the for-profit sector. Consumers benefit by having access to lower cost services that might not otherwise be available to them, especially those of modest means. And the facts show that the banking industry, which is engaged in an effort to put credit unions out of business, continues to mislead Congress into thinking that their very existence is threatened because of credit unions and their tax status. But banks continue to earn record profits. And if you saw the oil industry ads in the *Washington Post* last week, you would have noticed that in fact the banking industry recorded the highest profits of all U.S. industries during the second quarter of 2005—even more than the pharmaceutical industry. While the banking industry continues earning record profits, credit unions provide a nearly 7-to-1 return to consumers on the dollar, benefiting them by over $10 billion dollars in yearly savings.

Credit unions are an important part of the financial life of American consumers. And the tax-exempt status of credit unions is the glue that holds credit unions and their not-for-profit approach to cooperative financing together. If the tax exemption were removed—if 87 million Americans were forced to pay taxes solely because of their membership in a credit union—it would lead to the end of the movement that we know. Credit unions would become banks, and the consumers would pay dearly, not only in higher taxes, but in higher fees and less return on their savings and borrowings.

Thank you again, Mr. Chairman, for the opportunity to address the Committee in its effort to review the tax-exempt status of credit unions.

Chairman THOMAS. Thank you, Ms. May. Mr. Plagge, is that correct?

STATEMENT OF JEFF L. PLAGGE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FIRST NATIONAL BANK OF WAVERLY, WAVERLY, IOWA, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. PLAGGE. That's correct. Plagge.

Chairman THOMAS. Okay.

Mr. PLAGGE. Mr. Chairman, my name is Jeff Plagge, and I am President and CEO of First National Bank, a community- and employee-owned bank in Waverly, Iowa. We just celebrated our 141st anniversary. I am grateful for the opportunity to testify about the credit union tax-exemption, and, on behalf of the American Bankers Association, and thank you for holding this hearing. As we've heard many times, Federal Credit Unions pay no income tax. In 1937, Congress exempted Federal Credit Unions from all forms of taxation—Federal taxation, and chartered them with the specific mission of helping people of small means. Traditional credit unions still fulfill this mission by providing basic financial services to a well-defined group. Unfortunately, an increasing number of credit unions have abandoned this core mission. Instead of helping people of small means, sophisticated credit unions are expanding into commercial lending, buying naming rights to sports stadiums, financing luxury hotels, and building elaborate headquarters. My written testimony is filled with examples of these and other activities.

How does a $5.2 million contribution for naming rights to a sports arena serve credit union members? If a credit union can add the entire State of Washington to its field of membership, what has happened to the common bond? If a credit union is making business loans to non-members, what does that have to do with tax-exempt purpose, and who is indirectly being subsidized? In my hometown, the $1.1 billion John Deere Community Credit Union is more than five times larger than our $200 million community bank. Fueled by its Federal tax-exemption, the John Deere Community Credit Union competes virtually for every one of my customers regardless of their income, employment, or need. On the local level—and this is what this is about, where all competition plays out—the effects can be dramatic to our community bank and others like it around the country.

Credit unions' tax-exemption gives them a significant price advantage over tax paying banks that offer essentially the same products and services, and it enables credit unions to grow much more rapidly. The fact is in more and more communities, credit unions are many times larger than the local banks that are competing in that market. For example, my bank's average agricultural and business loan size is $52,000. John Deere Community Credit Union's business loan size is more than twice that, and that is still a reasonable amount, and there are others in the testimony on page seven that talk about some of the more aggressive business lending things going on. The Federal Government is subsidizing super competitors against nearly 8,000 taxpaying community banks in this country that have $500 million or less in assets. There are now 263 credit unions with assets of more than $500 million each, and more than a hundred credit unions with assets more than a billion dollars each. Studies by the Federal Reserve and the GAO show banks served more low and moderate income people than credit unions. The National Community Reinvestment Coalition has also concluded that the average bank is more often the source to credit of people of modest means than credit unions.

The NCRC says most people would be surprised to learn that banks are doing a better job of serving low- and moderate-income people than credit unions. Credit unions argue that their tax status exists because they are not-for-profit and cooperatively owned. But being a not-for-profit cooperative does not justify a tax-exemption. In fact, most cooperative member-owned and not-for-profit financial institutions are now subject to Federal taxation of some kind. Credit unions enjoy the sweetest tax deal of all of them. In contrast, mutual insurance companies, mutual savings banks, and mutual savings and loan associations lost their tax-exemption years ago. Removing their tax-exemption did not diminish their vitality. These institutions are healthy, well capitalized, and profitable. During the last 5 years, mutual savings banks and mutual savings and loans paid $2.9 billion in corporate income tax. Just like my bank, they are paying their fair share. This cannot be said today for some of the new breed of large and aggressive credit unions. These financially sophisticated complex credit unions should be required to stay within their mission or be taxed and regulated like the rest of us. The ability of community banks like First National to compete depends on it. Thank you, Mr. Chairman.

[The prepared statement of Mr. Plagge follows:]

Statement of Jeff L. Plagge, President and Chief Executive Officer, First National Bank of Waverly, Waverly, Iowa, on behalf of the American Bankers Association

Mr. Chairman, my name is Jeff Plagge. I am president and CEO of First National Bank, a $200 million community bank located in Waverly, Iowa. The American Bankers Association (ABA) appreciates the opportunity to comment to the Ways and Means Committee on the tax exemption of credit unions. Our comments focus on the evolution of traditional credit unions serving "people of small means" to full service, financially sophisticated institutions that compete head-to-head with tax-paying banks and fail to serve the mission for which they have been exempted from all federal taxation.

ABA on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

This statement addresses three central points:

I. A new breed of credit union has abandoned its mission to serve those of small means. In fact, studies show banks are more often a source of credit to low- and moderate-income people than are credit unions.

II. Being a non-profit cooperative does not, alone, justify a tax exemption. Fairness dictates equal tax and regulatory treatment for similarly situated institutions. Yet complex credit unions take advantage of their tax-exempt status to unfairly compete with tax-paying banks, offering virtually indistinguishable products and services in the same markets.

III. Congress has repeatedly recognized that there are limits to tax exemptions and has acted to eliminate them for entities that stray from their intended public policy goals. Credit unions that have abandoned their core mission should be taxed or required to convert to bank charters.

I. Complex Credit Unions Outgrow Justification for Tax Subsidy

Chairman Thomas, as you stated earlier this year, "Tax-exemption is an important benefit and the Congress has a responsibility to oversee and assure the American taxpayer that the tax-exempt sector is living up to its legal responsibilities." We agree. ABA recommends that Congress examine credit unions' tax-advantaged status, particularly those that have strayed from the original credit union mission. While many credit unions remain true to their original mission, today a growing number of credit unions have abandoned their roots and inappropriately taken advantage of their tax-exempt status.

Continuing the special tax treatment for institutions that look and act like tax-paying banks has public policy consequences. The size of the "tax expenditure" as the Office of Management and Budget (OMB) calls it, is already big—more than a billion dollars per year. And basic economics tells us that it will get bigger as tax-favored firms take business away from taxpaying firms. Simply put, as these credit unions get larger, so does the tax expenditure.[1]

This is not how the credit union movement began. Closely-knit groups of people would pool their resources to provide small loans for one another. Credit unions were originally created and granted their tax exemption to fill a market void that existed in consumer finance in the early 20th Century. Few, if any, banks at that time offered consumer loans, and consumers, especially people of modest means, had few options to obtain credit.

By 1934, the United States had approximately 2,500 credit unions, with 38 states and the District of Columbia offering credit union charters. Later that year, a federal credit union charter became available. Whether chartered by a state or the federal government, membership was limited to people with close bonds because familiarity was critical to the "character" loans made by credit unions. The commonality of interest among members—their common bond—was the essence of credit unions. It was the justification for their unique place in our financial system.

Who Serves Low- & Moderate-Income Consumers? Increasingly, Not Credit Unions

Today, an array of options for credit is available for everyone, dramatically reducing the justification for granting credit unions special treatment. In fact, studies re-

[1] Tax expenditures are defined in the law as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability."

veal banks serve more low- and moderate-income people than credit unions do, despite credit unions' supposed focus on "people of small means," as required by the Federal Credit Union Act.

The Federal Reserve's 2001 Survey of Consumer Finances revealed that only 36 percent of the households that primarily used credit unions had low- and moderate-incomes in contrast to 42 percent of the households that primarily used banks. In 2003, the Government Accountability Office (GAO) released a report that showed that 64 percent of households that primarily use a credit union are middle and upper income, as compared to 58 percent of households that primarily use banks. It also found that banks provided 34 percent of their mortgage loans to low- and moderate-income borrowers while credit unions issued just 27 percent of their loans to these borrowers in 2001.

A recent study conducted by the National Community Reinvestment Coalition (NCRC) concluded that banks are more often a source of credit to people of modest means than credit unions are. "In the year 2005, after 70 years of federal supervision of credit unions, most people would be surprised to learn that banks are doing a better job of serving low- and moderate-income people than credit unions," the NCRC study said.[2]

Think Federal Credit Union exemplified in its 2003 Annual Report how credit unions' focus has changed when it stated: "Yesterday our challenge was to provide financial services to members who could not get services elsewhere. Today our challenge is to provide financial services to members who can get services anywhere."

Instead of focusing their resources on people of modest means, today a new breed of institution that bears little resemblance to a traditional credit union is capitalizing on its tax-exempt status to offer products and services far beyond any meaningful common bond. ***There are now more than 100 credit unions each with assets greater than $1 billion***. There are 263 credit unions with assets of more than $500 million each.

In nearly half the states in this country, a credit union would rank among the top ten banks in terms of size. As Gene Portias, president of the Credit Union Association of Oregon, stated: "In a lot of places, credit unions are the major financial institution."[3] Complex, aggressive institutions increasingly dominate the industry, yet still try to hide behind the veil of a "traditional" credit union.

The credit unions' own surveys suggest that their image of serving moderate- and lower-income people is no longer valid. The profile of the average credit union member today—higher than average income, better educated, and more likely to be in a professional occupation than his or her non-member counterpart—is not one typically associated with people needing taxpayer-supported financial services. According to a recent demographic survey conducted by the Credit Union National Association (CUNA), the average household income of credit union members is 20 percent higher than nonmembers—$55,120 versus $45,790.[4]

The fact is that bank customers are more likely to be from low- and moderate-income households than are credit union customers—yet credit unions continue to enjoy the tax expenditure purportedly because they serve people of modest means. As Bruce Shawkey of Credit Union Management magazine stated, ". . . [C]redit unions' 'bread and butter' members are middle-aged white males with mid- to upper-incomes."

Even credit union executives are disturbed that credit unions have strayed so far from their original mandate to serve people of small means. Citing CUNA's numbers on the average household income of members served by credit unions, Armando Cavazos, president of Credit Union One in Ferndale, Michigan, said, "We should almost feel guilty about serving people of affluence."[5]

Jim Blaine, CEO of State Employees CU in Raleigh, NC, conceded, "Maybe we've gotten so sophisticated we don't want to get our hands dirty with poor folks any more. That's what we were created to do, and sometimes I think we're forgetting that."[6]

And, Ed Gallagly, president/CEO of Central Florida Credit Union, says, "There's no question that subconsciously—and even consciously—some credit unions are try-

[2] "Credit Unions: True to Their Mission?" NCRC, 2005.

[3] "CUs, Banks Put Up Dueling Bills in Oregon," American Banker, March 25, 2003.

[4] CUNA National Member Survey, 2002.

[5] "How to Head Off Coming Under CRA Dominates Debate at CUNA Convention," American Banker, October 14, 1994, p. 9.

[6] "Are Credit Unions Dodging Their Responsibilities? One CEO Thinks So." Credit Union Journal, December 2, 2002, p. 11.

ing to run-off unprofitable members. I hate to use that term run-off but that's what's happening."[7]

Credit Union Subsidy is Used Inappropriately

As morphed credit unions stretch their fields of membership across ever-larger geographic areas and venture into new business activities, is the tax benefit being passed on fully to credit union members? In more and more cases, the answer is no.

In some cases, it is going to build elaborate corporate headquarters like Golden 1 Credit Union's new 200,000 square foot headquarters in Rosemont, California, costing more than $30 million and GTE Federal Credit Union's new 125,000 square-foot headquarters located on a 12.5 acre campus in Tampa, at a cost of about $22 million. And Digital Credit Union in Massachusetts paid $5.2 million for the ***naming rights for an arena*** in Worcester (MA) in 2004 and University FCU in Texas is contributing $13.1 million to the renovation of the University of Texas's baseball stadium in exchange for naming rights. Is this an appropriate use of the credit union tax exemption?

Communities are not being served, either. Credit unions, unlike banks, are not required to meet the obligations set forth in the Community Reinvestment Act (CRA). In a study of Virginia credit unions, professors Murphy and O'Toole found that "banks and savings institutions in Virginia are putting a greater percentage (88 percent) of their deposits back into the community in the form of loans than are credit unions (76.3 percent). In other words, tax treatment of credit unions has not resulted in a higher proportion of loans going to meet the needs of the communities they serve."[8]

Business Lending—Extending Tax-Subsidized Services to Commercial Entities

In addition to serving a wealthier customer base, the new breed of credit unions is looking for profitable opportunities in commercial lending, thus further extending the tax exemption beyond its original purpose. Business lending by credit unions grew by almost 50 percent in 2004. More than 420 credit unions have at least 5 percent of their total loans in business loans and almost 240 have at least 10 percent of their loan portfolio in business loans. Nearly 250 credit unions are designated guaranteed lenders by the Small Business Administration (SBA), and more than 300 credit unions have either purchased or participated in business loans made to non-members. Should members' savings fund business loans to non-members?

"Successfully banking the small-business owner is one of the keys to increased credit union profitability," the Credit Union Executive Society noted. And many credit unions are following this course to boost profits. Jean Faenza, EVP for Telesis Community CU, describing her credit union's pursuit of business owners, stated: "Remember, every business owner is a consumer who has other accounts . . . small business are employers. We're greedy—we want all of those accounts."[9]

Lending by credit unions is big business. For example:

- Less than one year after commencing operations, CU Business Group, LLC said it had processed more than $50 million in business loans—with the average-sized loan worth more than $600,000. Larry Middleman, CU Business Group's President/CEO, noted that the "[l]oan packages are much larger than we anticipated."[10]
- The average business loan outstanding at Florida's Vystar Credit Union is $463,000; at California's Telesis Community Credit Union, it is $693,100.
- Coastal Federal Credit Union with $1.5 billion in assets has ventured into complex commercial real estate transactions where the average size loan exceeds $4 million.[11]
- Texans CU has approximately $382 million in business loans on its book and funded Prism Hotel's acquisition and construction financing of the 280-room Radisson Memphis Hotel in Tennessee.[12]

[7] "Are Members Really Leaving Credit Unions? CEOs Offer Their Take," Credit Union Times, April 14, 2004, p. 42.

[8] A Study of the Evolution and Growth of Credit Unions in Virginia: 1997–2002, by Neil Murphy and Dennis O'Toole, November 2003.

[9] "Show of Hands Indicates CU Interest in Biz Lending," Credit Union Journal, September 15, 2003, p 11.

[10] Credit Union Journal, September 1, 2003.

[11] Credit Union Times, March 30, 2005, p. 23.

[12] "Texans CU's Business CUSO Taking Off; Loans Range from Multi-Million to Just Thousands," Credit Union Times, February 2, 2005, pp. 1, 36.

- Spokane Teachers CU financed a $3 million renovation of the Montvale Hotel, a luxury hotel in Spokane, Washington.

These are all loans for which a bank would likely compete. It is inappropriate that credit unions leverage their tax subsidy to compete unfairly head-to-head with tax-paying banks and become "super competitors." It also begs the question of who is indirectly subsidized by the credit unions tax exemption: Luxury hotels and commercial real estate developers? Is this what Congress intended?

Subsidizing a "Super Competitor" That Preys on Community Banks & Small Credit Unions

Although the credit union industry argues that the issue of credit union competition is about big banks against little credit unions, it is really about the billion dollar credit unions "fueled by their federal tax subsidy" against the community banks in this country. Competition in financial services occurs on the local level. The fact that the banking industry as a whole is much larger than the credit union industry has no bearing on head-to-head competition in the local market.

There are nearly 8,000 community banks in this country with assets of less than $500 million each. The credit union tax exemption adversely affects these tax-paying banks. It gives credit unions a significant price advantage over tax-paying banks that offer the same products and services and enables credit unions to grow much more rapidly.

The fact is that in more and more communities, it is the credit union that is many times larger than the local banks. This trend facilitates a market share shift from tax-paying institutions to tax-exempt credit unions. For example:

- In North Carolina, State Employees Credit Union (SECU), which has assets of over $12.7 billion and 185 branch locations and 860 ATMs, competes directly with almost one hundred community banks, but is 44 times larger than the average-sized community bank.
- The Credit Union of Texas, with $1.6 billion in assets, is almost seven times larger than the 17 community banks it competes with in its market.
- Visions FCU with $1.6 billion in assets boasts that it was the largest mortgage lender in Broome County (NY) for 2003.
- Some aggressive credit unions are now so large that they dominate the deposit market in their areas, competing head-to-head with large and small banks alike. For example:
- With $2.9 billion in assets, Vystar Credit Union in Northeast Florida dominates its market area with more deposits in the region than First Alliance, Wachovia and Bank of America combined.
- With $5.6 billion in assets, Boeing Employees' Credit Union in Washington State dominates its market area with more deposits there than Washington Mutual and Bank of America combined.
- With $1.8 billion in assets, ENT Federal Credit Union in Colorado dominates its market area with more deposits in the region than Wells Fargo and World Savings Bank combined.

It is obvious that the tax subsidy provides credit unions a very large pricing advantage. For example, professors Murphy and O'Toole found that ". . . credit unions are enabled to offer a 67 basis point advantage in loan pricing and deposit pricing over banks as a direct result of the fact that credit unions do not pay state or federal taxes. In a highly competitive industry, the 67 basis point government subsidy is substantial."[13]

And the competition is not just banks versus credit unions, but also morphed credit unions against traditional credit unions. Lorraine Ratoni, CEO of Sacramento County Grange Credit Union noted: "We're losing members to larger credit unions. We're having a harder and harder time competing."[14] Again, who does Congress intend to subsidize?

Laura Bruce, writing for Bankrate.com, states, "To say credit unions don't compete with one another or with banks just doesn't ring true anymore. There's competition. Some of it's for sheer survival; some of it's for market share. Not all credit unions have jumped into the fray. Some employment or organization-based credit

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[13] A Study of the Evolution and Growth of Credit Unions in Virginia: 1997–2002, by Neil Murphy and Dennis O'Toole, November 2003.

[14] "Friendly Foes: Once Allies, Credit Unions Now Compete for Customers," by Barbara Marquand, Sacramento Business Journal, May 24, 1999.

unions may have a very successful niche and be able to stay small and survive, maybe even thrive—but they're part of a shrinking minority." [15]

Policies Fuel Credit Union Consolidation and Unlimited Growth

While credit unions have grown to serve wealthy customers and offer commercial loans, NCUA continues to expand their tax subsidy without restraint. Through *pro forma* approvals of multiple common bonds, rapid approvals of community charters beyond any reasonable definition of "local," and liberal interpretations facilitating expansion of business lending and other service offerings, NCUA has fueled the evolution towards larger, more complex credit unions. Today, a single credit union can serve thousands of unrelated groups, or huge geographic areas with millions of people. This is not what Congress intended.

Mergers and acquisitions have also played an important role in the expansion of many large credit unions. The result is fewer, but larger, credit unions. Since 2000, the credit union industry has consolidated at twice the rate of the banking industry. Over the last 4 years, nearly 1,100 small credit unions have disappeared.[16]

Community charters are the fastest expanding segment of the credit union industry. Federal law permits a credit union to serve anyone in a "well-defined, local community, neighborhood or rural district." [17] In fact, the number of federal credit unions with community charters has more than doubled from 464 in 1999 to 1,051 as of year-end 2004.

The use of the term "community" has reached absurd proportions. NCUA and various state regulators have approved community expansions that include some of the largest cities in the country, entire Metropolitan Statistical Areas (MSAs), multiple counties across state lines and even entire states as part of a credit union's field of membership. The result, according to GAO, is that the average size of a community charter approved by NCUA jumped almost three-fold from a population of 134,000 people in 1999 to 357,000 in 2003.[18] And this growth occurred in spite of NCUA's acknowledgment that when Congress, in 1998 legislation, added the requirement that community credit unions be "local," it intended to limit the size of such credit unions.

As Scott Waite, Senior Vice President and Chief Financial Officer of the $3 billion-plus Patelco Credit Union, said on the credit union's expansive community charter in Northern California: "[I]f you walk past our front door, you can join." [19]

A few of the many other examples that illustrate just how far the definition of "local community" has gone include:

- NCUA approved a community charter application for LA Financial CU to serve the 10 million plus residents of Los Angeles County—larger than the population in 42 states and a geographic area equivalent in size to the states of Rhodes Island and Delaware combined.
- Wescom Credit Union's field of membership includes the 16 million people living in Los Angeles, Ventura, Orange, Riverside, and San Bernardino Counties.
- In 1999 and 2000, Meriwest Credit Union added the three million residents of Alameda and Santa Clara Counties and expanded its reach into Contra Costa and San Mateo Counties with a combined population of 1.7 million, and into the City and County of San Francisco—representing another 750,000 people.
- Boeing Employees CU in Washington State amended its field of membership to include the whole state of Washington.

To evade field of membership limitations, credit unions have been forming charitable foundations. Anyone who makes a donation to the foundation is eligible to join the credit union. For example, $2.1 billion GTE FCU advertises on its website: "You can join GTE FCU even if you are not eligible for membership through your employer or a family member. GTE FCU sponsors a non-profit educational financial club, CUSavers."

And some credit unions do not even go through the pretense of having a common bond. As Greenwood CU in Rhodes Island states, "membership . . . is open to all responsible people who want to be a member."

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[15] "The Changing Face of Credit Unions" By Laura Bruce, Bankrate.com, December 19, 2003.
[16] http://www.ncua.gov/news/speeches/2005/matz/463,20,Slide 20.
[17] Public Law No.: 105–219.
[18] Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversightand Share Insurance Management. General Accounting Office, October 2003 (GAO–04–91), p 35.
[19] Bankrate.com.

II. Being a Not-for-Profit Cooperative Does Not Justify the Tax Exemption

Since morphed credit unions no longer embody the traditional characteristics that justify continuing their tax exemption, they have been forced to offer a new justification. According to Dick Ensweiler, Chairman of the Credit Union National Association, "Credit unions have the tax status that they do because they are not-for-profit, cooperatively owned, democratically governed, and generally led by volunteers from among the membership." [20]

But being a not-for-profit cooperative does not justify being tax exempt.

In fact, most financial institutions that had traditionally been described as "cooperative, member-owned and not-for-profit" are now subject to federal taxation. Those institutions include mutual insurance companies, mutual savings banks, and mutual savings and loan associations. Each of these financial institutions lost their tax exemption years ago—mutual insurance companies in 1942, and mutual savings banks and mutual S&Ls in 1951. Why?

In the 1951 decision, Congress determined that:

- These cooperative and mutual institutions were in "active competition" with taxable institutions and continuing their tax exemption would be "discriminatory;" and,
- They had evolved into institutions whose "investing members are becoming simply depositors, while borrowing members find dealing with a savings and loan association only technically different from dealing with other mortgage lending institutions in which the lending group is distinct from the borrowing group." [21]

Thus, Congress determined that mutuality alone was not sufficient to continue the tax exemption for these institutions. This conclusion is particularly telling because of the similarities between mutual savings institutions and credit unions, as noted by the U.S. Treasury Department: "Mutual thrifts are the federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not-for-profit entities, and are owned by their depositors, or members, rather than by shareholders."[22]

In fact, in a letter to the editor appearing in the September 28, 2005 edition of the *Credit Union Times,* Ralph Leas, president and CEO of Golden Bay FCU writes, "I have long believed that the original logic of a credit union tax exemption has expired and that credit unions, like other business cooperatives in the United States, should pay their fair share."

The tax preference originally provided to credit unions was a way to subsidize financial services for individuals with low and moderate income. Many traditional credit unions still dedicate themselves to this purpose. But the metamorphosis to healthy and sophisticated credit unions shows how quickly this goal can be abandoned.

If the tax exemption is no longer conditioned upon the policy goal of serving low- and moderate-income individuals and offering a limited menu of products and services, the special tax treatment for morphed credit unions cannot be justified

III. Congress Has Acted to Limit Tax Exemptions

Financial entities that have retained their tax-exempt status are generally subject to limitations that restrict either their size or the breadth of their membership. Moreover, their tax-exempt status remains based on narrowly crafted congressional directives relating to the service of niche markets or to achieving limited policy goals. With the erosion of both the common bond and the easing of limits on credit union products and services, credit unions' are free to stray from their original mission.

The question of where the line should be drawn to control the taxpayer expenditure needs to be answered. Every expansion of a morphed credit union expands the tax expenditure. OMB estimates that the credit union "tax expenditure" will exceed $7.5 billion [23] over the next five years, and this figure does not take into account additional lost state tax revenue. And most of the tax subsidy goes to the most aggressive credit unions—those that are least likely to embrace traditional credit union principles. In fact, the largest 100 credit unions absorb 40 percent of the tax expenditure—quite a contrast with the 29 percent of just 6 years ago.

This is a substantial subsidy and, with inadequate restraints, it will grow rapidly. Basic economics tells us what happens when a tax-exempt firm and a taxpaying

[20] American Banker, April 2, 2004.
[21] 56 Stat. 798.
[22] Comparing Credit Unions with Other Depository Institutions, United States Department of the Treasury, January 2001, p.25.
[23] OMB, February 2005, for the fiscal years 2006 through 2010.

firm offer the same products: the tax-exempt firm grows at the expense of the tax-paying firm. As business flows to the tax-exempt firms and away from taxpaying institutions, the size of the tax expenditure will grow. The public deserves a thorough review to assure that the tax expenditures are being appropriately spent and not disadvantaging competing businesses that carry out the same activities on which they pay taxes or fueling abandonment of the mission for which the exemption was created.

As mutual insurance companies and mutual savings banks became similar to, in the words of the Congressional Budget Office, "profit-seeking corporations", Congress eliminated their tax exemption.[24] In the Revenue Act of 1942, Congress made mutual insurance companies with annual gross receipts in excess of $75,000 subject to federal income tax. This change was made to restrict the exemption to smaller institutions deserving of the class exemption. Since that time, the threshold for eligibility for this exemption has been changed to annual net written premiums not exceeding $350,000.

Conclusion & Recommendation for Change

Congress needs to ask: *"At what point do large, diversified credit unions cease to be the type of institutions the Congress envisioned to be worthy of a tax exemption?"* Complex credit unions, which have evolved into full-service financial institutions serving the general public, are a far cry from the small, traditional credit unions that served distinct groups of "people of small means" that Congress sought to assist when it provided tax subsidies to credit unions in the 1930's.

These credit unions are very different from the many credit unions that have remained true to the spirit of the original credit union charter. Credit unions that are indistinguishable from tax-paying banking institutions no longer deserve their tax exemption and should be required to pay taxes or to convert to a bank charter.

One possible tax model currently applies to most cooperatives organized for economic purposes (as opposed to charitable or limited purposes), i.e., Subchapter T of the Internal Revenue Code. Members, or "patrons" would be responsible for paying taxes on earnings (i.e., interest on deposits) passed through to them (at their individual tax rate). Retained earnings—which do not benefit individual members—would be taxed at the general corporate rate. Under this approach, credit unions could continue to pass on their financial profits to their members, either through higher interest rates on deposits or through lower interest rates on loans. Their tax-advantaged growth, however, would be eliminated. At a minimum, Congress needs to curb the ability of credit union regulators to expand the size of the subsidy at the taxpayers' expense.

Removing the tax exemption for mutual savings institutions and mutual insurance companies did not diminish their vitality. These institutions are healthy, well-capitalized, and profitable. During the last five years, mutual savings banks and mutual savings and loans paid $2.9 billion in corporate income taxes. Just like my bank, they pay their fair share. The same cannot be said for today's new breed of credit unions.

Thank you.

Chairman THOMAS. Thank you. Mr. Hayes?

STATEMENT OF DAVID E. HAYES, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURITY BANK, DYERSBURG, TENNESSEE, AND CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. HAYES. Mr. Chairman and Members of the Committee, my name is David Hayes. I am President of Security Bank in Dyersburg, Tennessee, and the Chairman of the Independent Community Bankers of America. I am pleased to appear today on behalf of the ICBA and its nearly 5,000-member community banks throughout this great country. My bank has $135 million in assets. I have 70 employees, and I live in a community 19,000 people, located in rural west Tennessee. The ICBA believes this hearing will

[24] Budget Options, CBO, March 2003, p. 218.

help foster a better understanding of the genuine concerns and frustrations community banks often have as they work in their local communities, pay their fair share of taxes, and compete head on with credit unions. The credit union sector often states that they represent only a small portion of the entire financial service industry. However, an important distinction is that most often tax-exempt credit unions compete head on with taxpaying community banks of similar size. Research finds that the largest overlap in terms of competition in size is in the $10 million to $100 million asset size class, which includes about half of all banks and about 40 percent of all credit unions. In this class, banks and credit unions primarily compete with each other and not with the largest banks or credit unions.

Unfortunately, the dramatic tax burden difference between these taxpaying banks and tax-exempt credit unions places community banks at a severe competitive disadvantage. Congress originally allowed credit unions tax and regulatory advantages in the thirties for the purpose of helping serve people of modest means and with a common bond. But today, the notion of modest means and common bond is lost. For example, the local credit union in my community promotes that anyone who lives, worships, attends schools, or business or other legal entities and their families are eligible customers. Today, credit unions have more than 87 million customers, reaching the wealthy and the middle-income classes. In fact, there are more than one hundred billion dollar credit unions providing sophisticated banking services. Consequently, today, the $680 billion credit union industry is quite similar to any other financial service provider except for their special regulatory treatment and tax subsidy. Because of their rapid expansion, the credit union tax subsidy will cost an estimated $31 billion in lost Federal revenue over the next decade, according to the Tax Foundation.

Credit unions often cite that they deserve tax-exempt status because of their mutual ownership structure. However, mutual structures can be taxed and are, in fact, taxed. In 1951, Congress eliminated the tax-exemption for savings and loan and mutual savings banks on the grounds that they were no longer unique from other taxpaying financial institutions. Perhaps most troublesome is the failure of the credit union industry to provide any unique service to individuals of modest means despite their large tax subsidy. A growing body of research shows how banks consistently exceed credit union performance in lending to women, minorities, and low- and moderate-income borrowers in communities. Ironically, little of credit unions' tax subsidy is passed to their members. The Tax Foundation research shows that a huge portion of the credit union earnings are retained and used for expansion. Only six of 50 basis points may go to credit union borrowers through lower interest costs. While more and more research shows credit unions are not providing any special services to the people of modest means, the credit union industry has embarked on expanding its business lending. It is doubtful that Congress in passing the Federal Credit Union Act 1934 envisioned credit unions making commercial loans. Yet, credit unions continue to advance measures to skirt their legal business lending cap.

As long as credit unions are tax-exempt, the ICBA will oppose expanding credit union powers, such as H.R. 2317. In conclusion, the credit union industry is similar to other taxpaying banks serving the same customer base. Notably, the Tax Foundation credit union research concluded that today the principal justification for tax-exemption would seem to be that it already exists. Over the past decade, Security Bank has paid more than $4.2 million in Federal income taxes alone, and we proudly support our local community. During that same period of time, Security Bank has committed over a million dollars to fund scholarships at local community colleges, while tax-exempt credit unions have done very little. When asked to contribute for civic needs, the response typically is we can't because we're not-for-profit. Community banks pay their taxes and serve their communities. We urge the Committee to consider policies that would help create greater parity between tax-exempt credit unions and taxpaying community banks. Thank you very much.

[The prepared statement of Mr. Hayes follows:]

Statement of David E. Hayes, President and Chief Executive Officer, Security Bank, Dyersburg, Tennessee, and Chairman, Independent Community Bankers of America

Mr. Chairman, Ranking Member Rangel, and members of the committee, my name is David Hayes, Chairman of the Independent Community Bankers of America (ICBA)[1] and President and CEO of Security Bank, a $135 million community bank in Dyersburg, Tennessee. I am pleased to appear today on behalf of ICBA and its nearly 5,000 members nationwide to testify on the "Review of the Credit Union Tax Exemption."

The ICBA commends Chairman Bill Thomas and the Committee members for undertaking this important hearing and for examining the current tax treatment of the credit union sector. We hope that this hearing helps foster a better understanding of the concerns and frustrations community banks often have as they try to best serve their local communities and compete head-on with tax-exempt credit unions.

Credit Union Tax Exemption Warrants ReassessmentThe origins of the credit union industry's current tax exemption reach back to the Great Depression, a time when basic financial services were extremely limited for low- and moderate-income Americans. Congress originally allowed credit unions generous tax and regulatory advantages in the 1930s for the purpose of helping serve individuals of modest means. Individual credit unions were largely limited to serving individuals sharing a common bond—in most cases, the same employer or occupation. While the credit union tax subsidy has continued for seven decades, today's modern financial services industry is robust, highly competitive, and offers a plethora of products and services readily available to all consumers.

Over the decades, the tax-exempt credit union industry has changed dramatically too. Credit unions have expanded aggressively in size and scope. The tax-exempt credit union industry has been growing even faster than commercial banks. According to the Federal Reserve Bank of Kansas City's research, credit union growth is on a steady upward climb with accelerated growth beginning in 2000.[2] Between 1994 and 2004, credit union annual asset and deposit growth exceeded that of commercial banks in the United States. Commercial banks witnessed 7.7% annual asset growth and 6.9% annual deposit growth during 1994 to 2004 while credit unions experienced 8.4% annual asset growth and 8.1% deposit growth during that same decade.[3]

Today, credit unions have a broad customer base of more than 87 million customers, reaching the wealthy and middle-income classes and they offer the full

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. Founded in 1930, ICBA is celebrating its 75th anniversary year. For more information, visit ICBA's website at www.icba.org.

[2] Federal Reserve Bank of Kansas City. Financial Industry Perspectives, July 2005.

[3] Ibid. p.6.

range of financial products and services. In fact, credit unions are even expanding a large and growing commercial lending business.

Consequently, today's $680 billion credit union industry has become quite similar to any other financial service provider, except for their special regulatory treatment and tax subsidy. As our Nation struggles with its fiscal policy demands and strives to make our tax system more fair and equitable, it is important for lawmakers to assess ways to create greater parity between tax-exempt credit unions and competing taxpaying entities.

Congress Made Other Tax-Exempt Financial Service Providers TaxableCredit unions often cite that they deserve tax-exempt status because of their "mutual" ownership structure. However, mutual structures can be taxed—and in fact they are. For example, Congress did impose taxes on mutual savings banks and mutual insurance companies. Today, all mutual thrifts pay federal taxes at the same rate as other for-profit companies. The savings and loan associations and mutual savings banks were not subject to the federal income tax until 1951. By 1951, Congress recognized the services of the thrifts and their customer base evolved so they were not much different from other financial service providers. The equitable policy solution was to include thrifts in the tax base and Congress eliminated their tax subsidy on the grounds they were similar to competing taxpaying corporations.

Likewise, today's tax-exempt credit unions have grown to resemble other competing financial service providers which calls into question the ongoing policy justification for the credit union tax subsidy. Credit unions can offer their more than 80 million customers mortgages, car loans, small business loans, credit cards, individual retirement accounts, brokerage services, and commercial loans. From the modest origins of the 1930s, today's tax-exempt credit union industry has dramatically changed to support the same broad customer base, and to provide the same range of services as taxpaying financial institutions. An equitable tax system would impose the same tax treatment on the same economic actions and transactions. Yet community banks face a greater tax and regulatory burden than tax exempt credit unions while they serve the same customer base.

Not Your Grandfather's Credit Union

Today there are one hundred credit unions with $1 billion or more in assets providing sophisticated banking products and services to wealthy and middle-income members while benefiting from tax-exempt status. Another noteworthy aspect of today's tax-exempt credit union industry is that corporate credit unions have been set up to provide the same sophisticated wholesale services as taxpaying correspondent banks. For example, U.S. Central Credit Union in Lenexa, Kansas holds more than $35 billion in assets and is owned by 72 member credit unions and has over $700 million in annual revenue. Today there are more than 30 corporate credit unions with over $110 billion in combined assets providing specialized and sophisticated banking services for credit unions.

No Common Bond

Today's credit unions have virtually no limit to their customer base as the "common bond" requirement has become meaningless. Take for example the recent credit union charter approval for the Los Angeles Financial Credit Union to serve: "Anyone who lives, worships, works in, or attends school in Los Angeles County." This encompasses a county of more than 10 million people and a geographic area larger than the states of Delaware and Rhode Island combined.

Similarly, the NCUA justified the expansion of the $1.6 billion Bethpage Federal Credit Union by saying that the 2.5 million people in its field of membership "interact by traveling along common roadways, receiving news from common media outlets, and shopping at common trade centers." One community credit union in Utah encompasses six counties—an area larger than the state of Maryland. The ICBA believes that these field of membership expansions undermine any concept of the common bond, rendering it meaningless and removing a key policy tenet underlying the purpose for any credit union tax-exempt advantage. The 87 million credit union customers are indistinguishable from the customers of community banks and thrifts.

Tax Exempt Credit Unions Not Serving Special Purpose

What is the ongoing policy justification for the credit unions' tax subsidy? Is the $680 billion credit union industry serving a unique purpose not met by other financial service providers? A large and growing body of research from the Congressional Budget Office, the General Accountability Office, the Woodstock Institute, the Tax Foundation and other research groups indicates that there is little or no evidence that today's tax-exempt credit unions are better serving the moderate and low-income individuals their tax-exempt status was intended to foster.

A recent Tax Foundation study concluded that the credit union tax subsidy has largely failed to deliver financial services to low-income people.[4] A 2005 study by the National Community Reinvestment Coalition determined that banks actually do a better job of fulfilling the credit unions' mission than the credit unions. This study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities."[5] A 2003 Government Accountability Office Study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks."[6]

Another study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle- and upper-income customers than lower-income households.[7] Similarly, a study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base.[8]

Additionally, a recent Congressional Research Service report added that through credit union service organizations, "credit unions may provide their members with panoply of sophisticated financial services and products that rivals the offerings of banks and thrifts." The CRS report notes that "over the past 30 years, most of the distinctions between credit unions and other depository institutions have been eliminated or reduced because of deregulation; consequently, the justification for the tax exemption for credit unions has been increasingly questioned."[9] Simply stated, more and more studies are piling up showing that today's credit unions are not serving any unique purpose.

Credit Unions Expand into Commercial Lending

While new research continues to show credit unions are not providing any special services to low- and moderate-income individuals, the credit union industry has greatly expanded its business and commercial lending. The credit unions recently sought and won regulatory approval to increase their small business commercial lending through the Small Business Administration (SBA). Ironically, Congress did not approve SBA business lending for credit unions, however the credit union regulator NCUA did. Notably, these SBA loans are not subject to the legal 12.25 percent-of-assets business-lending cap Congress specifically placed on the credit unions. So credit unions can expand their SBA business lending regardless of Congress' intent.

Credit unions continue aggressive measures to skirt the legal 12.25 percent business-lending cap, notably with the advancement of the "Credit Union Regulatory Improvement Act" (H.R. 2317) in the 109th Congress. This bill would raise the current statutory limit on business lending by tax-exempt credit unions to 20 percent of a credit union's assets from 12.25 percent, double the size of loans that would be excluded from the cap from $50,0000 to $100,000 and exclude certain other business loans from any limit.

As long as credit unions remain exempt from the tax and regulatory requirements imposed on community banks, the ICBA strongly opposes the expanded credit union powers in H.R. 2317. The bill substantially increases the credit unions' commercial lending powers and makes a number of statutory changes that are inconsistent with credit unions' historic mission and favored tax status. This Ways and Means Committee hearing on tax-exempts provides a solid opportunity to assess such credit union activities in light of the ongoing special tax treatment the credit union industry enjoys.

Commercial Lending Should Be Incidental Service

The ICBA continues to express concerns about the rapid expansion of credit unions into the commercial lending arena, so long as credit unions remain tax-exempt. It is doubtful that Congress, in passing the Federal Credit Union Act of 1934 for the purpose of helping credit unions serve individuals of modest means, envisioned credit unions making commercial loans. Indeed, H.R. 1151, the Credit Union Membership Access Act ("CUMAA"), which first codified the practice of commercial

[4] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005. www.taxfoundation.org

[5] "Credit Unions: True to Their Mission?" National Community Reinvestment Coalition, May 2005. www.ncrc.org

[6] General Accounting Office. "Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management." October 2003.

[7] Woodstock Institute. "Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-Income People. February 2002.

[8] School of Business, Virginia Commonwealth University. A Study on the Comparative Growth of Banks and Credit Unions in Virginia: 1985–1995." August 1997.

[9] Congressional Research Service. "Should Credit Unions be Taxed?" August 2005.

lending, actually imposed a strict limit on credit union business loans. The Senate Banking Committee report on this bill stated clearly that Congress intended that business lending by credit unions be incidental to, and not the main focus of, the services provided to their customers. Yet through SBA lending and expanded lending powers, credit unions are aggressively expanding into business lending.

Tax-Exempt Credit Unions Compete Directly With Taxpaying Community Banks

Today, tax-exempt credit unions compete directly against taxpaying community banks and continue to expand their financial service power, size, and scope. The top federal income tax rate applied to C corporation community bank income and S corporation community bank income allocated to shareholders is 35%. Additionally, income generated by C corporation community banks is subject to double taxation when distributed in the form of dividends or capital gains, creating a combined tax burden exceeding 57%.

In sharp contrast, tax-exempt credit unions pay no federal income tax yet compete directly with taxpaying community banks. The dramatic tax burden differential between taxpaying commercial banks and tax-exempt credit unions places community banks at a severe competitive disadvantage and highlights a specific example of where the tax code is extremely unfair.

The credit union sector often states that they represent only a small portion of the entire financial service industry. However, most often tax-exempt credit unions compete head on with community banks of similar size. The Tax Foundation's credit union study finds that the "largest overlap in terms of competition and size is in the $10 to $100 million size class, which includes about half of all banks and 30 to 40 percent of all credit unions. In this class banks and credit unions primarily compete with each other and not with the largest banks or credit unions." [10]

Growing Tax-Exempt Credit Union Industry Responsible for Significant Tax Loss

The ICBA would like to call to the Committee's attention the most recent independent research conducted on the tax cost associated with the credit union industry. Notably, the Tax Foundation's 2005 credit union study concluded that credit unions have used their tax-subsidized status to greatly expand in size and scope. Because of their rapid expansion, the Tax Foundation estimated that the credit union tax subsidy will cost $31 billion in lost Federal revenue to the U.S. Treasury over the next decade.[11] This study noted how large, multi-group and geographic-based credit unions have far exceeded their original tax-exempt statutory mission and unfairly use their tax-free status to compete with taxpaying community banks.

Little of the Credit Union Tax Subsidy Passed Through to Customers

Other important finding of the independent Tax Foundation's research into the tax-exempt credit union industry includes:

Corroborated by other studies of credit unions and banks, the direct and indirect evidence gathered for the Tax Foundation study shows that the equity holders of credit unions receive the tax savings as unusual returns. These unusual returns do not show up as relatively high dividends, however. Instead, they occur as unusually large retained earnings accumulated as net worth in their credit unions. The stakeholders' extra income reinvested in the credit union provides new capital that allows the credit union to grow faster than other institutions. Simply stated, rather than return the benefit of the tax subsidy to their members, a huge portion of credit union earnings are retained and used for expansion.

Only 6 Basis Points of 50 Basis Point Advantage Benefits Credit Union Members

According to the Tax Foundation's research, of the 50 basis points in subsidy that the tax exemption provides, at least 33 basis points accrue to owners in the form of larger equity and larger assets. Approximately 6 basis points may accrue to credit union borrowers through lower interest rates, and not more than 11 basis points are absorbed by higher labor costs. There is little or no effect on deposit rates or other costs. There appears to be substantial leakage of the credit union tax advantage into new expenditures to grow. For example, the $2.7 billion Digital Credit Union in Massachusetts recently spent $5.2 million to purchase the naming rights for an auditorium now called the DCU Center.

[10] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005. www.taxfoundation.org

[11] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005. www.taxfoundation.org

Little Justification for Credit Union Tax Exemption

Today credit unions continue to grow faster than banks, have little practical limitations on membership, and make business loans that increasingly have no limits on who can borrow, how much or for what purpose. More troublesome is the failure of the credit union industry to provide any special or unique service to individuals of modest means.

The Tax Foundation research concludes that today the principal justification for the tax exemption would seem to be that it already exists and, therefore, removing it could adversely impact thousands of institutions and their customers. Under current law, as it is being enforced, there is no good policy argument based on equity or efficiency for maintaining the tax exemption. And these institutions and customers are perceived, incorrectly, to be relatively lower income or associated with the economic security and progress of lower income people.

Tax Reform and Credit Unions

Policymakers are in the process of examining ways to make our tax code fairer and simpler while raising needed revenues. Fiscal neutrality and fairness in the Code would require addressing the special tax treatment of credit unions. Taxing some financial institutions that offer the same consumer deposits and loans while not taxing others, in particular credit unions, distorts the allocation of resources. It promotes the employment of deposit and credit resources in the tax-free credit union sector at the expense of their competitors, banks, thrift institutions and finance companies. Notably, the Tax Foundation study could not find any net benefit to members that could not or would not be available in the absence of tax-subsidized credit unions. Credit unions are not compelled by regulators to meet a higher standard in the service of low- and moderate-income customers, and there is no evidence that they do so voluntarily.

Conclusion

Credit unions are among the most rapidly growing financial firms in the country. Congress eliminated the tax exemptions for savings and loans and mutual savings banks decades ago on the grounds that they were similar to profit-seeking corporations. Since then, large credit unions have come to resemble thrifts and banks. The looser field of membership requirements allows credit unions, especially large ones, to expand their growth opportunities, reinforcing the competitive advantage obtained from their tax advantages.

Today's $680 billion tax-exempt credit union industry is conspicuously similar to other taxpaying financial service providers serving the same customer base. There is little or no evidence that credit unions are providing any unique or special benefit or service to people of modest means—the original impetus for their special tax treatment. Therefore, it is important for policymakers to reassess the tax-exempt status of the rapidly expanding credit union industry as part of any review and oversight of the tax-exempt sector. This Ways and Means hearing on the tax-exempt credit union sector is a welcome first step.

Community banks pay their taxes and serve their communities. Community banks play a vital role in the U.S. economy as a critical source of lending for individuals, small businesses and farms across America. The ICBA applauds the Ways and Means Committee for considering policies that would help make the tax code more equitable as it is applied to tax-exempt credit unions and taxpaying community banks.

I sincerely appreciate the opportunity to offer our comments for this important hearing and to highlight areas where the tax code is extremely unfair. The ICBA looks forward to working with the Committee and we are encouraged by your ongoing efforts to fairly assess the standing of tax-exempt credit union industry.

Chairman THOMAS. I thank the gentleman. Mr. Macomber?

STATEMENT OF MARK E. MACOMBER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, LITCHFIELD BANCORP, LITCHFIELD, CONNECTICUT, ON BEHALF OF AMERICA'S COMMUNITY BANKERS

Mr. MACOMBER. Thank you, Chairman Thomas. First, I'd like to express my gratitude to Congress Nancy Johnson for her kind introduction today. Nancy represents our district, our State, and our Nation extraordinarily well. Chairman Thomas, Ranking Member Rangel, and Members of the Committee. I am Mark Macomber. I am President and CEO of the Litchfield Bancorp in Litchfield, Connecticut. I am here this afternoon representing America's Community Bankers, where I serve as first Vice chairman of the board of Directors. I want to thank Chairman Thomas for his leadership in reviewing the appropriate application of tax-exemptions for cooperative and not-for-profit organizations and in particular for today's hearing, which is addressing the credit union industry. My institution is a $180 million state chartered community bank that is part of a two-bank mutual holding company. We are one of 765 mutual savings institutions that operate throughout the country alongside community banks organized as stock companies.

Today, my remarks will focus on the unfair competitive advantages that credit unions have compared to community banks like mine. We are facing a looming crisis unless tax policy favoring multi-billion dollar credit unions is changed. We urge the Committee to create a fair tax system that encourages a diversity of community credit providers, offering competitive products and paying taxes to support the public needs of our Nation. The Nation's mutual savings institutions hold over $250 billion in assets and paid $800 million in taxes in 2004. Mutual institutions have a long and vibrant history and have demonstrated an enduring commitment to our communities. Over 35 percent of mutual institutions have been in existence for 100 years or more. My own institution was chartered in 1850. Mutual institutions are cooperative. They were founded to serve the average American. We are a critical part of our local community—its life, its culture, and its economic future. We have survived depressions and recessions, world wars, and natural disasters.

In 1951, we survived taxation. Despite the revocation of our tax-exemption, mutual savings institutions continue to experience growth and thrive as pillars in the communities we serve. The parallel to the development of mutual savings institutions and credit unions is a very close one. In 1951, this Committee determined that mutual institutions were mature and provided a broad range of banking products and services, and, as a result, should become subject to taxation despite their cooperative status. I never had the opportunity to meet my predecessors from that time, but I am quite sure that they didn't like losing their tax-exemption. However, the Committee's decision was the right one based on principles, principles of equity, fairness, allowing the market to allocate resources and generating revenue to support essential functions of government. In our written submission, Chairman Johnson states that, and I quote this, "in 1951, Congress found the mutual thrifts had essentially lost the essence of their mutuality; and, therefore, lost their tax-exemption."

Her submission reflects a total lack of understanding of mutuality then and now. My own bank lives up to the intent and standards of the community service envisioned by its incorporators in 1850. She is simply wrong on this count. Today, the credit union industry is a $646 billion segment in the financial services industry, and is growing rapidly. This growth, driven primarily by multi-billion dollar credit unions, is increasingly displacing community banking. This trend will accelerate unless the Committee takes action. Inaction will result in more concentration and less competition driven only by tax incentives and not by economic efficiency. The parallels between mutual savings banks 50 years ago, including my own bank, and today's conglomerate bank-like credit unions cannot be ignored. Conglomerate full-service credit unions are competing for the same customers and offering the same products as community banks. In fact, credit union service organizations, CUSOs, as used by Federal Credit Unions, are in abuse of their tax-exempt status. Allowing credit unions to create new companies that are outright purchase companies is not only unfair, but completely unjustifiable and further expands their tax-exemption.

These credit unions offer every conceivable financial service, and serving more than most community banks. The range of services even includes airplane leasing, and, as the Chairman noted, pet insurance. Individual credit unions have been granted geographic markets as large as 11,000 square miles and so-called fields of membership of over 10 million people. This last number, again alluded to—referred to by the Chairman, is particularly phenomenal because it means that there is one credit union today serving a population greater than that of 42 of the 50 States. I say it again because it bears repeating. Mr. Chairman and Members of the Committee, like mutual savings institutions in 1951, these credit unions should be recognized as a mature industry that has a responsibility to contribute to essential federally funded initiatives. In 1951, Congress concluded that the continuance of tax-free treatment for mutual institutions would be discriminatory. Clearly, continuing a tax-free treatment for bank-like credit unions would be equally discriminatory today. Thank you for the opportunity to testify before your Committee today. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Macomber follows:]

Statement of Mark E. Macomber, President and Chief Executive Officer, Litchfield Bancorp, Litchfield, Connecticut, on behalf of America's Community Bankers

Chairman Thomas, Ranking Member Rangel and Members of the Committee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $180 million state chartered community bank, part of a two bank mutual holding company. I also serve as CEO of the holding company.

I am here this morning representing America's Community Bankers (ACB), where I serve as First Vice Chairman of ACB's Board of Directors. I want to thank Chairman Thomas and his staff for their leadership in exploring the outdated tax exemption that bank-like credit unions continue to enjoy at the detriment of community banks across the country, and the impact of foregone revenue on strained government finances.

My testimony is in four parts as follows:

1) History of Mutual Institutions and their Taxation;
2) History and Background of Credit Unions;
3) Taxation & Legislative History of Today's Credit Unions;
4) Mission of Credit Unions and How They Have Strayed.

The History of Mutual Institutions and their Taxation

Americans have always been entrepreneurs. Almost 200 years ago, when Americans of limited means could not gain access to the commercial banking system, neighbors pooled resources to create mutual savings institutions. As customers of these institutions, they insisted on quality service for themselves and their communities. As stewards, they delivered it.

The contributions of mutual institutions are documented in the history of American banking and the histories of the communities that have benefited from the mutual institutions tradition of service. For nearly two centuries, the nation's mutual institutions have contributed to the quality of life in cities and towns across the United States. An industry of independent, strongly capitalized and highly efficient institutions with a commitment to community service has flourished. Individuals of diverse backgrounds have formed businesses that strive to address the need for credit and services in communities.

As the first financial institutions in our country, mutual institutions in the United States were founded by individuals, for themselves and their neighbors. The doors of commerce that banking opened for the well-to-do in the early days of the country were closed to average citizens. Mutual institutions stepped into this breach to provide high quality consumer and small business banking services to the depositors and to the communities they serve. They continue this tradition today, and have become a critical part of their local culture and community.

Beginning just 40 years after the Declaration of Independence, mutuals were founded to provide banking services and credit access for ordinary citizens whom the established banking community ignored. Whether state or federally chartered, mutual institutions serve the average American regardless of family background, occupation or belief. These early mutual institutions did not pay taxes.

State chartered mutual savings banks, the earliest forms of mutual savings institutions, date back to 1816. The first legally sanctioned mutual savings bank in the world, The Provident Institution for Savings, in Boston, Massachusetts, was patterned after similar institutions in England and Scotland. Its founders dedicated the institution to providing a "means of contributing to the welfare of the working classes."

This was the forerunner of what became the mutual savings bank—one of the two mutual savings institution charters that eventually became a permanent part of the U.S. banking system. The other—the building and loan associations—later evolved into the present savings and loan associations. Federal savings and loans associations were first chartered in 1933 after the enactment of the Home Owners Loan Act. These institutions were chartered with the express purpose of promoting and providing homeownership.

Provident Institution for Savings had as its purpose the encouragement of thrift among low- and middle-income persons. One of the reasons for the popularity of the new mutual institutions was the ease of use—workers could deposit as little as five cents and could withdraw the monies as needed.

About 765 mutual institutions—including mutual holding companies—hold over $250 billion in assets. Mutual institutions have written and hold about $175 billion in loans, and in addition they service about $35 billion in mortgage loans that have been sold to the secondary mortgage market. Mutual banks have helped millions of families live the American dream by writing countless loans for homes, cars, education and small businesses, and to help see families through difficult times.

Mutual institutions demonstrate an adaptability that allows the development of new products. Like their stock-owned competitors, they grow through internal expansion and by combination with other federally insured depository institutions and branch networks. This flexibility and adaptability is evidenced by the fact that 263 mutual savings institutions operating today have been in existence for 100 or more years. These venerable institutions, the oldest of which has operated for 185 years, constitute 35 percent of all mutual institutions operating today.

Mutual banks have survived depressions and recessions, world wars, natural disasters and taxation because of a distinctive management strategy that is focused on the long-term future of the bank and community. Directors or trustees have a fiduciary responsibility to ensure that their institution meets the highest standards of safety and soundness. Mutual managers are free from the short-term focus of financial analysts who expect higher earnings every quarter and are thus able to look to the long-term needs of their institutions and communities.

Mutual institutions are the perfect role model of community banks and the community banking philosophy of putting customers and community first. Mutuals are critical participants in the rapidly evolving financial services marketplace. We believe that the orientation toward community service, local decision-making and stable employment in mutual banks are important keys to the continued success of any community in which they are located. Mutual institutions have demonstrated an adaptability that allows the development of new products as well as growth. While mutual institutions have a continuing need to be competitive and profitable, they demonstrate a responsiveness to community that goes well beyond profits and strives to improve the quality of life of their neighborhoods. Managers of mutual institutions believe that their charter is well suited to support non-profit and other civic enterprises.

Until 1951, mutual institutions of all types, including mutual savings and loans associations, mutual savings banks, and cooperatives, were tax-exempt. In 1951, the tax exemption was repealed and these entities became subject to the regular corporate income tax on a phased-in basis. It was believed that mutual institutions were mature enough and were providing a sufficiently broad range of banking products and services that they should not retain preferential tax treatment.

In 1959 the Ways and Means Committee described the criteria laid down as guidelines for considering such changes in taxation:

1. Equity and fairness;
2. Progression in the distribution of tax burdens;
3. Allowing free play of the market in allocating resources;
4. Providing a climate for economic growth;
5. Ease of taxpayer compliance and administration of the law.[1]

Although mutual institutions initially were permitted to defer portions of the new tax liabilities by establishing special bad debt reserves to encourage the accumulation of reserves, these deferrals were progressively eliminated in a series of changes, principally in 1962 and 1969, and were eliminated entirely in 1986. Despite being progressively subjected to full taxation over a period of years, mutual institutions have thrived as pillars in the communities they serve.

Over the past 15 years, the number of mutual institutions has grown as a share of all banks. This change has occurred because the cooperative structure and community focus of mutual institutions has insulated them in part from the "merger frenzies" that have sometimes gripped markets for publicly traded banks. Today, mutual savings institutions are stable, competitive, tax-paying institutions that operate under flexible charters conducive to offering a wide range of essential banking services to the communities in which they operate. It is little wonder that in recent years the memberships of two dozen credit unions have chosen to convert to a mutual institution charter.

History and Background of Credit Unions

Credit Unions can also be state or federally chartered. State credit unions were first chartered in the United States in the early twentieth century. Federal credit unions are chartered under the authority of the federal credit union act, which was enacted in 1934.

A federal credit union is a tax-exempt, cooperative financial institution owned and run by its members. Credit unions enable members to save and borrow money. Members pool their funds to make loans to one-another. The volunteer board that runs each credit union is elected by the members. In 1900, the credit union concept crossed the Atlantic to Levis, Quebec. There, Alphonse Desjardins organized a credit union to relieve the working class from usurious interest charged by loan sharks. In 1909, Desjardins helped a group of Franco-American Catholics in Manchester, New Hampshire organize *St. Mary's Cooperative Credit Association*—the first credit union in the United States. An ironic footnote—while it remains a credit union today, it recently changed its name to St. Mary's Bank. The *Massachusetts Credit Union Act* became law in that same year. The Massachusetts law has served as a basis for subsequent state credit union laws and the Federal Credit Union Act. Credit unions became increasingly popular in the 1920's. People had more money to save and could afford durable goods. However, they needed a source of inexpensive credit. Credit unions began growing because commercial banks and savings institutions typically did not provide consumer credit. In 1920, the Massachusetts Credit Union Association began promoting the development of credit unions in that state. Within a year, Massachusetts chartered 19 new credit unions. By 1925, 26 states had passed credit union legislation. By 1930, that number grew to 32 states with a total of 1,100 credit unions. In 1934, President Roosevelt signed the Federal Credit Union Act into law, authorizing the establishment of federally chartered credit unions in all states.The purpose of the federal law was ***"to make more available to people of small means credit for provident purposes through a national system of cooperative credit . . ."*** A statutory exemption from taxation was not provided until 1937. Two reasons were given for granting the exemption: 1. Taxing credit unions on their shares, much as banks are taxed on their capital shares, "places a disproportionate and excessive burden on the credit unions" because credit union shares function as deposits; 2. "Credit unions are mutual or coop-

[1] "Outline of Study by Committee on Ways and Means of Federal Tax Revision," Press Release, Committee on Ways and Means, U.S. House of Representatives, June 5, 1959.

erative organizations operated entirely by and for their members. . . .” Competition in the 1970s brought major changes in the products and services offered by financial institutions. Credit unions did not want to be left out. In 1977, federal legislation enabled credit unions to offer expanded services, including share certificates and mortgage lending. During the decade the number of credit union members more than doubled and assets in credit unions tripled to over $65 billion. Deregulation, increased flexibility in merger and field of membership criteria, and expanded member services characterized the 1980s. High interest rates and unemployment in the early ’80s brought supervisory changes and insurance losses. With the Share Insurance Fund near bankruptcy, the credit union community called on Congress to approve a plan to recapitalize the Fund. In 1985, federally insured credit unions recapitalized the NCUSIF on their own by depositing one percent of their shares into the Share Insurance Fund. Backed by the “full faith and credit of the United States Government,” the National Credit Union Share Insurance Fund has three “fail safe” features: Federal credit unions must maintain a one percent deposit in the Fund; Premiums are levied by the Board if necessary; and when the equity ratio exceeds 1.3 percent ($1.30 on deposit for every $100 insured), the Board sends a dividend to credit unions. Since the recapitalization, the NCUA Board has charged credit unions a premium only once. In 1991, the Fund dropped to a 1.23 percent equity level and credit unions were asked to pay a premium. Credit union failures declined steadily throughout the 90’s and the Share Insurance Fund grew. **Taxation and Legislative History of Today’s Credit Unions**

The credit union industry is a $646 billion segment of the financial services industry that paid $0 in taxes last year. In fact, the credit union industry has contributed no tax dollars to our country over the past 69 years, creating a competitive inequity that must be remedied. By comparison, mutual savings institutions hold less than 40 percent of the assets currently held by credit unions, but paid $800 million in taxes, while credit unions pay nothing.

To gain a better understanding of the need for tax equity among financial service providers, it is useful to review the dialogue that took place when the tax exemption for savings associations and mutual savings banks was repealed in 1951 and when tax deductible reserve provisions for these same entities were reviewed ten years later. By doing so, it becomes clear that the parallels between savings associations and mutual savings banks 50 years ago and the conglomerate credit unions of today cannot be ignored.

1951 and 2003: Active Competition With Taxpaying Financial Service Providers

Today’s conglomerate, full-service credit unions are competing for the same customers and are offering the same products as community banks, large commercial banks, and even brokerage firms. Like the savings associations and mutual savings banks of 1951, these institutions should be recognized as a mature industry that has a responsibility to contribute to the nation’s armed forces, educational programs, homeland security, transportation system, and other important federally funded initiatives.

Prior to the Revenue Act of 1951, savings and loan associations and mutual savings banks were exempt from federal income tax under the premise that they were cooperative enterprises that played an important role in the national priority of financing residential mortgages, and therefore should be exempt from taxation.

In 1951, Congress indicated that these institutions had grown in financial strength to the extent that they should be expected to bear their fair share of the tax burdens of the Nation. The Senate Report for the Revenue Act of 1951 states:

Mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. The continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory. So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. [Eliminating the special treatment] would place mutual savings banks on parity with their competitors.[2]

Likewise, today some credit unions have evolved to become significant competitors for public banking services. In fact, credit unions are more like banks today than savings associations were in 1951. In 1951 federal mutual savings associations could

[2] S. REP. 82–781 (1951) *reprinted in* United States Code Congressional and Administrative Service at 1993–1994.

not offer checking accounts and they were only authorized to engage in lending activities within their communities, which generally were limited to a 50-mile radius.

Today, credit unions offer mortgages, credit cards, business checking accounts, debit cards, IRAs, student loans, consumer loans, home equity lines of credit, agricultural and commercial loans, money market accounts, brokerage services, mutual funds, and insurance products. Furthermore, community chartered credit unions have been granted fields of membership stretching over 11,000 square miles.[3] In addition, LA Financial has been granted a field of membership encompassing all of Los Angeles County and all of its 10.1 million people. LA County has a population larger than the population in 42 states. It encompasses 4,084 square miles.

Because credit unions offer such a broad range of products and because they may offer those services to such a large geographic distribution of consumers and businesses, conglomerate credit unions are clearly competing with other taxpaying financial services enterprises. Large credit unions have matured, and special treatment should not continue for that fast growing portion of the credit union industry that looks and acts like banks. The words of the 1951 Senate Report ring just as true for credit unions today as they did for savings associations and mutual savings banks in 1951.

1961 and 2003: Reserves Represent Corporate Income

Some credit union advocates argue that taxing credit unions threatens the safety and soundness of the entire industry. They maintain that credit unions would not be able to survive such a tax because they are only able to raise capital through retained earnings.

Like credit unions, mutual savings banks return income earned from borrowers to savers after deducting expenses and required allocations to reserves. Despite the revocation of their tax exemption, mutual savings banks continue to experience growth. Moreover, just as Congress determined that the safety and soundness argument was not persuasive in the context of expanding the tax on mutual savings banks in 1961, the assertion that credit unions cannot withstand any taxation should likewise be rejected.

If the funds going into the corporation's reserve do represent corporate income, there would appear to be no reason, from the viewpoint of tax policy, for not taxing them. Moreover, other financial institutions that compete for the savers' dollars, such as commercial banks, do in fact have to depend primarily on surplus built up after taxes, rather than on access to the equity capital market, in order to obtain the protective capital cushions which all businesses need.[4]

The rationale for taxing credit unions is solid; the need to tax credit unions is pressing; and the motivation for taxing credit unions is central to the success of private enterprise. Credit unions have matured to a $646 billion industry, and rising federal and state deficits confirm the need for fairness. Congress should review the government-created competitive disparity between credit unions and community banks, particularly those that are mutually organized, and should enact legislation that represents sound public policy, is fair to all competitors in our banking system, and is fair to the American taxpayer.

Please refer to Appendix I.

Mission of Credit Unions and How They Have Strayed

Credit unions are not fulfilling their mandate to serve persons of modest means.

Congress chartered credit unions in 1934 to serve persons of modest means. In return, credit unions were exempted from taxation. However, an October 2003 General Accounting Office ("GAO") report indicates "that credit unions served a slightly lower proportion of low- and moderate-income households than banks." Similarly, a 1991 GAO report found "no evidence that today's credit union members are for the most part of small means."

Further, the credit union industry has vehemently opposed efforts to require credit unions to engage in special efforts to serve low-income customers or neighborhoods like banks and savings institutions. In fact, in a March 30, 2005 editorial the *Credit Union Times,* by Mike Welch, stated: "ACB apparently thinks credits unions' first obligation is to serve communities in which they operate. Wrong. CUs' number one obligation is to serve the changing financial needs of the members who own it. Of course, the community will also be served as a by-product." The comment is self-

[3] Tooele Federal Credit Union's community field of membership consists of Salt Lake County, Davis County, Weber County, Morgan County, and Summit County, and Tooele County Utah. The geographic areas of these counties are available at http://quickfacts.census.gov/.

[4] Treasury Department Report of July 1961 on the Taxation of Mutual Savings Banks and Savings and Loan Associations at 8.

serving and ignores the substantial federal safety net provided to credit unions through the National Credit Union Share Insurance Fund, in addition to the substantial tax subsidy under discussion today. This would be like a bank saying that serving shareholders is sufficient and serving the bank's community is a mere afterthought. Credit unions' not-for-profit status is no excuse for an exemption from community reinvestment responsibilities. Banks and savings institutions have Community Reinvestment Act responsibilities regardless of whether they make a profit.

Field of Membership Expansion. In 1998, the passage of the Credit Union Membership Access Act ("CUMAA") formalized the establishment of several types of credit union membership. It specifically identified single common-bond credit unions, multiple common-bond credit unions, and community credit unions.In so doing, CUMAA encouraged many mid-size and large credit unions to dramatically grow their memberships and expand into new markets. This is particularly true with credit unions that converted to community charters. In some cases, the geographic limits of communities were extended to boundaries that not only defied the definition of "community," but also defied logic.

Emboldened by CUMAA, the NCUA has not only allowed, but actually encouraged credit unions to abandon their historically well-defined groups, such as employees of a specific company, and move on to adopt all-encompassing "community" charters. On December 10, 2004 a federal judge for the U.S. District Court for the District of Utah struck down an NCUA decision granting a charter spanning six counties in the state of Utah, which would have covered an area larger than the state of Maryland. In the decision the judge expressed concern that the NCUA was acting "as a rubber stamp or cheerleader for any application brought before it." The judge went ever further to criticize the NCUA for failing to do due diligence. Judge Dale A. Kimball said that "If the NCUA had conducted a critical analysis of the information provided, it should have recognized areas of concern that required further discussion."

Through such charters, the credit union can serve multiple unrelated membership groups under one umbrella, including much of the general public over a wide geographic area. Recent changes to the NCUA's field of membership rules also provide for the creation of an occupational common bond based on a trade, industry or profession. Members can also share a common bond by virtue of providing similar products, providing similar services or sharing the same profession or trade.

Credit Union Service Organizations (CUSOs). Many credit unions have formed subsidiaries known as credit union service organizations ("CUSO"s) that have contributed significantly to the dramatic growth of complex, conglomerate credit unions. CUSOs offer sophisticated products such as trust administration and investment services. CUSOs also provide non-traditional financial services such as real estate brokerage, pre-paid legal service plans, and travel agency services. In many cases, CUSOs are established to offer services not permitted by a credit union's charter. All Income generated through CUSOs should be taxed.

List of Permissible CUSO Activities[5]

Checking and currency services

- Check cashing
- Coin and currency services
- Money orders, savings bonds, travelers checks, and purchase and sale of U.S. Mint commemorative coins services

Clerical, professional, and management services

- Accounting services
- Courier services
- Credit analysis
- Facsimile transmissions and copying services
- Internal audits for credit unions
- Locator services
- Management and personnel training and support
- Marketing services
- Research services
- Supervisory committee audits

[5] 12 CFR 712.5. The specific activities listed within each pre-approved category are provided as illustrations of activities permissible under the particular category. The NCUA rules state that this is not an exclusive list.

Business loan origination

Consumer mortgage loan origination

Electronic transaction services

- Automated teller machine services
- Credit card and debit card services
- Data processing
- Electronic fund transfer services
- Electronic income tax filing
- Payment item processing
- Wire transfer services
- Cyber financial services

Financial counseling services

- Developing and administering IRA, Keogh, deferred compensation, and other personnel benefit plans
- Estate planning
- Financial planning and counseling
- Income tax preparation
- Investment counseling
- Retirement counseling

Fixed asset services

- Management, development, sale, or lease of fixed assets
- Sale, lease or servicing of computer hardware or software

Insurance brokerage or agency

- Agency for sale of insurance
- Provision of vehicle warranty programs
- Provision of group purchasing programs

Leasing

- Personal property
- Real estate leasing of excess CUSO property

Loan support services

- Debt collection services
- Loan processing, servicing, and sales
- Sale of repossessed collateral

Record retention, security, and disaster recovery services

- Alarm-monitoring and other security services
- Disaster recovery services
- Microfilm, microfiche, optical and electronic imaging, CD–ROM data storage and retrieval services
- Provision of forms and supplies
- Record retention and supplies

Securities brokerage services

Shared credit union branch (service center (operations)

Student loan origination

Travel agency services

Trust and trust-related services

- Acting as administrator for prepaid legal service plans
- Acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity
- Trust services

Real estate brokerage services.

Please refer to Appendix II.

Credit Union Member Business Loans

In September 2003 the NCUA revised its rule to allow federal credit unions to circumvent Credit Union Membership Access Act's statutory assets. CUMAA stated that member business loans could be 1.65 times the credit union's net worth or 12.25% of its total assets. However, the new rule allows credit unions to exclude purchases of participation loans and non-member loans from this statutory cap upon

NCUA approval. The Department of Treasury opposed the proposal, but unfortunately the final rule virtually ignored Treasury's concerns and opposition.

Large Sophisticated Credit Unions Hide Behind the Small Credit Union Image

Over the years, two distinct credit union industries have emerged. The first adheres to its statutory mission. The other hides behind the small credit union image to preserve its federal tax exemption. Even the National Credit Union Administration recognizes that the expansion that it has allowed to occur within the credit union industry now makes many credit unions indistinguishable from banks and savings associations. At a November 18, 2004 NCUA Board meeting, board member Deborah Matz observed that many legislators consider small credit unions to be the symbol of all credit unions. As a result, she reasoned, it is important to preserve small credit unions so that the entire credit union industry will not be taxed.

We see no value in subsidizing credit union conglomerates that offer diverse, high-end financial products and services to the general public. It is a common misperception that credit unions offer only basic banking services to local hospital employees, schoolteachers, and government workers. In reality, many credit unions have evolved into complex financial institutions that do not have meaningful membership restrictions.

For example, credit unions offer commercial loans, stocks, mutual funds, margin and option accounts, trust services, and other sophisticated products. Furthermore, many credit unions do not have a distinct field of membership and offer financial products and services to the general public. For instance:

- LA Financial Credit Union's field of membership includes all of Los Angeles County and its 10.1 million residents. Los Angeles County is home to more than 25% of California's population and more people than reside in 42 of this nation's 50 states.
- Suncoast Schools FCU in Tampa, FL caters to persons in 14 counties and has assets of over $4 billion.
- Citizens Equity First CU in Peoria, IL serves over 14 counties and employees of over 550 select companies.
- Rhode Island-based Greenwood Credit Union advertises that membership "is open to all responsible people who want to be members."

$800 million Greylock Federal Credit Union in Massachusetts recently ran radio advertisements telling listeners if they "have a pulse," they are probably qualified to join Greylock Federal Credit Union.

Specific Abuses by Credit Unions Pet Insurance?

Yes, pet insurance. Believe it or not, CUNA has an article on their website boasting the fact that two of the largest credit unions in Colorado offer pet insurance to their members.

Fido, Kitty offered insurance through CUs

COLORADO SPRINGS, Colo. (7/23/03)—El Paso County, Colorado's two largest credit unions have taken the family pet under their field of membership—at least indirectly.

Ent FCU and Air Academy FCU are offering pet insurance coverage for dogs and cats through a Colorado CU League subsidiary that also helps credit unions offer trust services, dental insurance and other products (*The Gazette* July 20).

Depending on the level of coverage and Fido's size, age, and health, monthly premiums for dogs are $9.95 to $55.90. For Kitty, the rates range from $8.50 to $26.90. Compare that to the $2,000 a year one owner of a rambunctious mutt paid in vet bills, including $1,800 for surgery to remove a corn cob stuck in the dog's intestines. The coverage includes up to $3,000 per incident for accidents, broken bones, bites, and illness.

Ent began offering the coverage last month when it became available from the league and because members said pet care expenses were becoming a financial issue. Air Academy began offering pet insurance in May.

The credit unions share in the revenue produced by the pet insurance program, which offers checks and electronic greeting cards imprinted with a pet's photo, an online pet photo album, and discounts at a pet products retail chain.[6]

[6] Article reprinted from: *http://www.cuna.org/newsnow/03/system072203–9.html*

Credit Unions Are Not For Profit?

- Digital Federal Credit Union is spending $5.2 million for the naming rights to the Worcester Centrum Centre. In effect, the credit union's tax-free status means that local taxpayers will subsidize the cost of these naming rights by $2 million. Digital Federal Credit Union also conducted a major television advertising campaign during Boston Red Sox baseball games.
- Over the past year, $4.6 billion BECU sent 2.1 million direct mail pieces and drew in 20,000 new members.
- According to a July survey by the National Association of Federal Credit Unions, 39% of respondents indicated that they impose a minimum balance on share draft accounts while another 35% indicated that they charge monthly fees.
- Commodore Perry Federal Credit Union imposes a $5 check-cashing fee on members that maintain only a regular share account at the credit union, but no checking account, no loans, no active account. Members will also be charged for cashing checks if they withdraw the full amount of their direct deposit on the day it is deposited, but have no active accounts.
- Portland Teachers Credit Union President Cliff Dias earned $1.6 million in salary and bonus in 2003, according to a report the credit union filed with the IRS.

Unrelated Business Income Tax

As a general rule, not for profit organizations are subject to the unrelated business income tax (UBIT) on net income from activities that are not substantially related to the organization's exempt purpose. The Internal Revenue Service (IRS) has not issued guidance regarding the application of UBIT to non-traditional credit union activities, although credit unions in Alabama, Connecticut, and Colorado have reportedly received UBIT-related inquiries from the IRS.

Credit unions should not be permitted to offer such a wide array of products to the general public without being subject to some form of taxation. We urge the House Ways and Means Committee to study CUSOs in the context of evaluating how credit unions have evolved beyond organizations with limited fields of membership that provide financial services to persons of modest means. We support examining whether the UBIT or an UBIT-like tax should be applied to certain credit unions. Sophisticated credit unions should be recognized as complex financial institutions and should no longer be permitted to claim that they are part of a "mom and pop" industry that deserves to be exempt from federal income tax.

Credit unions compete with insurance providers and car dealerships as well as community banks

Redwood Credit Union recently formed RCU Insurance Services, a credit union service organization that offers insurance products to both credit union members and non-members living in the community. Redwood Credit Union also owns an auto center where members can shop for vehicles with on-site financing and auto insurance. (http://www.cuna.org/newsnow/products.html)

City County Credit Union, Margate, Fla., also owns a used car dealership for both credit union members and non-members. They also provide on site financing.

http://www.cuna.org/newsnow/archive/list.php?date=021005

Please refer to Appendix III.

Conclusion

Chairman Thomas, Ranking Member Rangel, and Members of the Committee, we thank you for inviting America's Community Bankers to testify on the "Review of Credit Union Tax Exemption." Over 50 years ago, this same Committee undertook an examination of the tax-exemption granted to mutual banks and savings and loans. After lengthy deliberation, the Committee concluded that mutual institutions were competing directly with banks and to continue the exemption should be discriminatory. The same is true today. We reemphasize that our concern remains with the sophisticated credit unions that have grown beyond their common bond and are as bank-like as mutual institutions that are taxed. From a competitive perspective, these credit unions have become tax-exempt community banks, creating situations in which a billion dollar, tax-free credit union can sit opposite a $180 million, non-stock, taxpaying mutual savings bank like mine. ACB commends the Committee and its staff for undertaking an examination of the tax-exempt sector, and we look forward to working with the Committee on this important issue.

Appendix I

Income tax liability 2003	$0 Would have paid $1.32 billion if taxed at the same rate as banks and savings associations.[7]	Lost exemption in 1952.	$7.5 billion.[8] Federal mutual savings associations paid over $285 million in 2003. All federally insured mutuals paid $1 billion.[9]	$30 billion.[10]
CRA obligations	No CRA obligations.	Predated the CRA. Mutual savings associations worked to maintain and foster the economic strength of communities they served.	The CRA requires insured depository institutions to serve and help foster growth in each of the communities they serve, including low- to moderate-income areas within their communities.	Same as federal savings associations.
Interest on consumer checking accounts	Federal credit unions may pay interest on both consumer and business checking accounts.	No. Checking accounts were not permitted.	Federal savings associations may not pay interest on business checking accounts. Offering interest bearing NOW accounts to individuals and nonprofit organizations is permissible.	Same as federal savings associations.

Appendix I—Continued

Income tax liability 2003	$0 Would have paid $1.32 billion if taxed at the same rate as banks and savings associations.[7]	Lost exemption in 1952.	$7.5 billion.[8] Federal mutual savings associations paid over $285 million in 2003. All federally insured mutuals paid $1 billion.[9]	$30 billion.[10]
Field of membership	Federal credit unions may serve only persons within their field of membership. Over the years, membership restrictions have been liberalized legislatively and by regulation. In 2003, the NCUA greatly expanded its field of membership rules. At a minimum, the new rules will allow 56 million additional people to qualify for credit union membership. Separately, some states have very liberal field of membership interpretations..	Mutual savings associations were authorized to lend within their communities, which generally was defined to comprise a 50-mile radius.	Not applicable.	Not applicable.
Lending limits	A federal credit union may lend to any one member up to 10% of its deposits..	Historically, mutual savings associations could lend up to a percentage of assets, generally between 15–20% of assets to a single borrower, depending upon loan type.	Lending limits track those for national banks. Federal savings associations also have an additional lending limit authority for residential development loans.	The single borrower limit generally is 15% of the bank's capital and surplus on an unsecured basis. An additional 10% limit is available if collateralized with fully marketable securities.

Appendix I—Continued

Income tax liability 2003	$0 Would have paid $1.32 billion if taxed at the same rate as banks and savings associations.[7]	Lost exemption in 1952.	$7.5 billion.[8] Federal mutual savings associations paid over $285 million in 2003. All federally insured mutuals paid $1 billion.[9]	$30 billion.[10]
Business lending authority	Federal credit unions may make business loans of up to 12.25% of total assets. However, a recent rule adopted by the NCUA allows credit unions to exclude purchases of participation loans and nonmember loans from the statutory cap if approved by the NCUA.	No.	Federal savings associations may make commercial loans in an aggregate amount totaling 20% of total assets, 10% of which must be in small business loans.	National banks have general commercial lending authority.
Unsecured consumer loans	Yes (12-year term limit).	No.	Yes.	Yes.
Insurance/securities powers	Yes.	No.	Yes.	Yes.

[7] Banks and savings associations pay approximately 40% of their income in federal and state taxes each year. According to the NCUA's 2003 Annual Report, Federal credit unions had a net income of $3.3 billion, 40% of which is $1.32 billion. President Bush's FY 2005 budget estimates that credit unions' federal tax exemptions will cost a cumulative total of $7.88 billion between 2005 and 2009.
[8] SNL Database.
[9] *Id.*
[10] *Id.*

Appendix II—Credit Union Products and Services*

Loan Products: Mortgate Loans; Commercial Loans; Commercial Property Loans; Aircraft Loans; Lines of Credit; Recreational Vehicle Loans (including Boats, MOtorcycles, Snowmobiles, and Waverunners); Automobile Loans; Home Equity Lines of Credit; Credit Cards; Student Loans.

Deposit Products: Individual Retirement Accounts; Checking Accounts; Money Market Deposit Accounts; christmas Colubs; Certificates of Deposit; Debit Cards.

Investment Products: Stocks; Margin Accounts; Option Accounts; Trust Services; Unit Investment Trusts; fixed Annuities; Variable Annuities; Retirement and Investment Planning; Mutual Funds; Retirement Plans (401 (k), 403(b), SEP, etc.); 529 Educational Savings Plans; Tas Free Municipal Bonds; Corporate Bonds; U.S. Government Bonds.

Insurance Products: Automobile Insurance; Term Life Insurance; Whole Life Insurance; Accidental Death and Dismemberment Insurance; Homeowners Insurance; Disability Income Insurance; Long Term Care Insurance; Renter's Insurance; Dental Insurance; Risk Management Insurance Needs Analysis; Credit Life Insurance.

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* This chart is intended to illustrate that credit unions have evolved into full service financial service providers that offer the same products and services as community banks. It is not intended to be a comprehensive list.

Services: Sweep Services; Online Banking; Wire Transfers; Safe Deposit Boxes; Savings Bonds; Cashier's Checks; Money Orders; Gift Checks; Extended Warranty Policies on New or Used Vehicles; Cash Back Real Estate Programs Members earn cash rebates when buying or selling real estate. Members are assigned a real estate agent. After settlement, a cash rebate is directly deposited into the member's account; Automobile Listing Services A computerized listing service that gives members access to listings of new auto prices, including the MSRP and the dealer's invoice costs. The guide also provides information on options and their prices; Discount Vehicle Buying Services Advisors search for new and used vehicles on a member's behalf.

Appendix III

Credit Unions: Fact vs. Fiction

Myth	**Fact**
Myth: Credit unions deserve to be exempted from taxation because they are cooperatives.	**Fact:** Credit unions are not the only cooperatively owned financial institutions. Like credit unions, mutually organized savings and loan associations and mutual savings banks return to savers income earned from borrowers after deducting expenses and required allocations to reserves. Mutuals pay corporate income tax on retained earnings (undistributed net income).
Myth: Credit unions are not-for-profit.	**Fact:** Credit unions are very profitable. They retain earnings and they are using those earnings to grow at a rapid pace. In 2002, federally insured "not-for-profit" credit unions had a net income of over $5.6 billion.[11] Further, these credit unions held over $37 billion in undivided earnings. Federally insured mutually organized savings institutions had a net income of approximately $1.6 billion and paid approximately $868 million in income taxes.[12]
Myth: Credit unions serve persons of modest means.	**Fact:** An October 2003 report by the General Accounting Office found that banks serve a higher proportion of low- and moderate-income households than credit unions. Credit unions are exempt from the Community Reinvestment Act and are not required to engage in special efforts to serve low-income consumers or neighborhoods.
Myth: Credit unions have limited fields of membership.	**Fact:** Credit unions no longer have the membership limitations that were originally justified their income tax exemption. Today, credit unions cater to the general public and serve the same customers as community banks. Credit unions that historically served well-defined groups, such as employees of a specific company, have moved to adopt "community" charters that allow them to serve the general public over a wide geographic area. Other "common bond" credit unions have been permitted to include over 1,000 unrelated membership groups within their field of membership.
Myth: Credit unions are a "Mom and Pop" industry.	**Fact:** Credit unions are a $623 billion industry. Approximately 100 credit unions have assets of $1 billion or more.
Myth: Community banks hypocritically seek additional Subchapter S benefits	**Fact:** The shareholders of Subchapter S banks pay taxes on their earnings regardless of whether those earnings are distributed. While a credit union with $1 million in retained earnings pays $0 in taxes, a Subchapter S bank with the same retained earnings pays close to $400,000 in taxes.

[11] NCUA 2002 Annual Report. Federally insured credit unions include federal and state charters that have share insurance. Federally chartered credit unions alone earned nearly $3.1 billion in 2002.

[12] SNL Database. Federally insured mutuals institutions include all federally chartered institutions as well as those state chartered institutions that have federal deposit insurance.

Chairman THOMAS. Thank you, Mr. Macomber. The gentlewoman from Connecticut. Does Mrs. Johnson wish to inquire?

Mrs. JOHNSON. Thank you, Mr. Chairman. There clearly is a difference between the very big credit unions and the smaller credit unions. Are there greater constraints on you membership area, Mr. Macomber, than on a credit union's membership area? Or membership isn't the right word—but your service area?

Mr. MACOMBER. Well, legally, we get to go across State boundaries. We certainly have to do some work. But we are not really restricted geographically as far as the State of Connecticut. There was at one time a law in place that had a 50-mile radius restriction on banks like mine. However, as a practical matter, again, we are $180 million bank, and exactly like credit unions, we generate all of our capital, all of it from retained earnings. As a bank our size, we really don't have access to capital markets for any consequential growth in capital, so we are also limited to where our capital comes from from retention earnings.

Mrs. JOHNSON. What is the regulatory burden of a small bank versus a small credit union?

Mr. MACOMBER. Well, we are not subject to CRA. And, as I think was mentioned earlier, there are a couple of recent—actually one as recent as 2003 that indicated that credit unions were not serving the lower-income and moderate-income individuals as well as smaller banks are doing, community banks are doing. I would like to quote actually something that was in the Credit Union Times. Their editor, Mike Wells stated that—and this is in response to a letter over my signature that was printed in his publication, "ACB apparently thinks credit unions' first obligation is to serve communities in which they operate. Wrong. CUs' number one obligation is to serve the changing financial needs of the members who own it. Of course, the community will also be served as a by-product." That is not exactly, you know, a ringing endorsement of what the Community Reinvestment Act is all about, and I think the performance of credit unions outside of what they are chartered to have done in 1934 supports that this statement is exactly how a lot of credit unions feel.

Mrs. JOHNSON. Is it more costly for a small bank to make a loan than it is for credit union to make a loan?

Mr. MACOMBER. That is hard to gauge. You know, I will say that the overhead in credit unions, looking at their statistics, tends to run higher. I don't think that is a function of what it costs to make a loan.

Mrs. JOHNSON. In this issue of size, is there any precedent in any other section, area of banking, to regulate differently according to size?

Mr. MACOMBER. Again, in the CRA area, banks now under the FTIC, the OTS, actually started this, and the FTIC has adopted similar rules. Banks of a billion dollars or less have a less detailed examination from a CRA perspective than banks of over a billion dollars.

Mrs. JOHNSON. Thank you. Thank you, Mr. Chairman.

Chairman THOMAS. Does the gentleman from New York wish to inquire?

Mr. MCDERMOTT. No.

Chairman THOMAS. Does the gentleman from Kentucky wish to inquire?

Mr. LEWIS OF KENTUCKY. No. Not at this time.

Chairman THOMAS. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. Thank you. Let me ask those from the community banks, are there any restrictions on credit unions that don't exist for you? Any of you want to answer that?

Mr. PLAGGE. I think probably the one right now, and it would be part of this CREAL legislation, there is some restrictions that they have as it pertains to the percent of business loans they can have as part of their assets. Right now that I believe is 12 and a half percent. They're seeking to get that to 20 percent. But one of the things that is discouraging to community banks in that percentage is they don't count loans currently below $50,000, and I think the legislation calls for not counting business loans below $100,000. As my testimony identified, almost all of our business loans as a percentage last year, 2004, 62 percent of our business loans—business and agricultural loans—were under $100,000. Now, what that legislation says is apparently they aren't even important enough to count. That's indeed a big part of our portfolio.

Mr. MACOMBER. Also Federal savings banks do have restrictions on commercial lending. They're restricted to 10 percent—excuse me 20 percent total; 10 percent, which has to be small business loans. So, there are restrictions on that part of the banking industry.

Mr. LEVIN. How about other restrictions that apply? How about interest rates? Any difference?

Mr. PLAGGE. We see it up and down the ladder. I can find credit unions where we have lower fees, lower rates. I can probably—they can probably find credit unions that have the reverse of that.

Mr. LEVIN. How about restrictions, though. Any legal restrictions?

Mr. PLAGGE. Restrictions on interest rates?

Mr. LEVIN. Yeah.

Mr. PLAGGE. You mean just state usury laws and so forth? The same. I would assume that would apply to credit unions in our State.

Mr. HAYES. That would be my guess is I mean—you know, the state law controls the interest rates on the——

Mr. LEVIN. How about for Federal Credit Unions? Isn't there a difference?

Mr. MACOMBER. Well, I think the Chairman mentioned that there's an 18 percent usury rate for Federal Credit Unions, which would probably match most States or perhaps be higher than some.

Mr. LEVIN. What is the largest credit union within 10, 15 miles of—or say 10 miles of each of your banks?

Mr. PLAGGE. I am in Waverly, Iowa. We have a branch of John Deere Community Credit Union, which is a billion one. They are in 33 I think now of the 99 counties in Iowa. So, they are by far—I think they are the seventh largest financial institution in the state. So, they are, by far, the largest in the State at this point.

Mr. HAYES. There is a small credit union in the community in which I live, and then 40 miles away, we have branches of one of the larger credit unions in the——

Mr. LEVIN. Forty miles away?

Mr. HAYES. Forty miles. Yes, we have facilities there.

Mr. MACOMBER. We are basically in the same situation. We have a small local credit union. But certainly within 35 or 40 miles, we have a billion dollar credit union as well.

Mr. LEVIN. Thirty-five or 40 miles? Okay. Thank you.

Chairman THOMAS. The gentleman from Texas, Mr. Brady, wish to inquire?

Mr. BRADY. Briefly, Mr. Chairman. I would ask the panel, back on the issue of small business access to capital, how does the tax-exemptions for credit unions impact for good or for worse access to capital of small business start ups and expansions? Who—what institution now, what type of institution now best serves those needs in our communities? I would—why don't reverse it from the earlier panel. Start with Mr. Macomber and head in that direction.

Mr. MACOMBER. Well, certainly, banks have the SBACU—in Connecticut, we have the CDAs. So, we have a number of government programs that are very helpful as far as start-up capital. We also provide start-up capital for folks that we've known, very much like credit unions. The different between a small bank like ours that has been in the same community for 155 years and that of a credit union that has been there for 50 years is pretty slim as far as knowing our customers and being able to help where it is appropriate. Start-up capital for new businesses is a very difficult thing to come by, as you know. Again, knowing our customers makes it easier for us than it might be for someone from outside the State.

Mr. BRADY. Thank you.

Mr. HAYES. The same for our institution and our community. I mean, you know, we are with our customers working in civic projects. We are working with them on school boards. We understand their needs. You know they understand that we are there to help them achieve their dreams. So, you know, I think we are a good source of that capital, being a community bank, because if our community doesn't grow, then our institution doesn't grow and we can't continue to add new staff. So, that is an important part we play. And, you know, I am looking at my loans for my board report next week. I would tell you that the majority of the loans that we've made in the last 30 days would be under $10,000.

Mr. BRADY. Thank you.

Mr. PLAGGE. As my figures show, I mean we make a lot of small business loans. We have the same basically structure that credit unions in our market would have. We have access to SBA loans and so forth. It is really not the issue of small business lending I guess that we say should be restricted with credit unions. It is the types of business lending that you are starting to see nationwide through the credit union industry—some of the examples I gave in my written testimony—and the amount of that that is actually occurring to non-members. So, geographically, even though they may not have a credit union branch in their market, there is business lending going on, leaping across markets and the credit union industry. So, it doesn't have to be—that competition doesn't have to come from the local branch in your market. So, I think what we look at is what is happening with the business loan exemption, and indirectly when you start seeing luxury hotels and those kinds of things being financed, who's being subsidized in the process? So, it is not so much the—being against credit unions and business lending. It is what you are starting to see and the lack of regulation or the lack of monitoring behind it from the standpoint of NCUA, saying is this what we intended that tax subsidy for.

Mr. BRADY. Thank you.

Ms. MAY. I guess. Short arms. I guess in my community, it is a little different. We are a low-income community, largely Hispanic. We were not doing member business loans. We had for many years prior to let's say 195 or so. But then we set back and said this wasn't something we wanted to concentrate on. In the late 'nineties, I started receiving a great amount of pressure from my State Senator and my State Representatives that there is lack of capital available in my city. We have an abundance of out of the local market banks that have moved into El Paso, and we see capital leaving in the form of deposits going elsewhere. We had—a brother of our Congressman had to go to a different State to get his small business loan made. So, we did reach out and start making small business loans. Now, our small business loans are averaging right around $120,000, $145,000. But they are largely to minorities, and, as I said, in a low-income community.

Mr. BRADY. All right. Thank you.

Vice Admiral DAWSON. Sir, we have also only recently begun business lending. Our average loan for a business loan is about $25,000. We see members such as spouses that start daycare centers; members who have transitioned to a second career and need to buy a fleet of two or three trucks. That is where we are concentrating right now.

Mr. BRADY. Great. Mr. Chairman, thank you very much.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Washington wish to inquire?

Mr. MCDERMOTT. Admiral and Ms. Ma, you represent the credit unions; is that correct? Can you give me your opinion about what evil brought about this oversight hearing? What is it that we are searching out? Why do you think you are being summoned before the U.S. Congress?

Ms. MAY. I believe we have heard some of that in our recent testimony here. We, as an industry, have grown to 6 percent of the financial assets of the Nation.

Mr. MCDERMOTT. Six percent?

Ms. MAY. Yes, sir. That it is if you exclude the Merrill Lynch's and so forth. I mean the insurance companies have gone into offering checking accounts. So, we have grown to 6 percent, and as contrasted with the mutual savings industry, which grew to 50 percent in the early '50—of the deposits. This is—our 6 percent seems to be perceived as a threat. I believe that the issue here is that we do not have to serve stockholders. We serve our members, and our members only. All our net income is returned to the members in the form of lower rates on loans, higher rates on deposits, and contributions to retained earnings, which provides safety and soundness. It seems to be a concern that our structure works in that manner. But I think as a result, we have, as quoted by Ms. Johnson from I believe it was Zion National Bank made the issue that if it weren't for credit unions, just think what their record profits could be.

Mr. MCDERMOTT. Admiral?

Vice Admiral DAWSON. Sir, at Navy Federal, we consider our tax-exemption to be a privilege. I am very happy to come here today and to explain how we use that privilege to the best use of the Nation and to our members.

Mr. MCDERMOTT. Is there anything about your credit union that would me it—now, I am talking about your own personal credit union, not your National status—that would—that you are worried about? Is there some kind of creeping problem there?

Vice Admiral DAWSON. No, sir. The Chairman's remarks at the beginning about transparency, accountability, and verifiability that is something that we work on very hard every day at our credit union, as I think all credit unions do, and I think we should. We owe that to our members and we owe that to you.

Mr. MCDERMOTT. But my understanding of the value here is we are talking about $600 billion in credit unions as opposed to about $4 trillion in the—and all the credit unions put together don't even come up to Citicorp. So, what is this threat? I mean how could you be a threat? Is it the idea would catch on, that people would form their own banks? Is that—it is kind of like a socialist germ that is infecting the body politic or what are we——

Ms. MAY. I do have an application to convert to a credit union if any of my peers would like it here at the table.

[Laughter.]

Mr. MCDERMOTT. Well, let me ask a technical question. If you have money—you have made some money, and you retain it; you don't give it out in dividends to your members. You use it as a capital to be used for your operation of your credit unions; is that correct?

Vice Admiral DAWSON. Yes, sir. That is correct.

Mr. MCDERMOTT. So, if you had to pay that, you could no longer keep it. You would have to pay taxes to the Federal Government. Where would you get that capital that you would use? You would have to go——

Vice Admiral DAWSON. There is no other source under current——

Mr. MCDERMOTT. But can't you get it from the Federal Reserve or some place? Maybe you should open it up so that you can go to the Federal Reserve? How would you function if you lose your capital?

Ms. MAY. We couldn't—we can only build capital from retained earnings. If—we pay out dividends on our member shares, which is the same as interest on deposit accounts. But we have to retain earnings into capital, which is held at a higher standard for credit unions than it is for our banking brethren. We have mandated capital standards under the 1151, which was passed in 1998. Without that capital, at the level we maintain it, and net income we have to contribute to it every year, we would not be considered as safe and sound as——

Mr. MCDERMOTT. You mean the law that was passed by the Republicans in 1998; is that correct?

Ms. MAY. Yes. This must be a fight between the Banking Committee and the Ways and Means Committee. I guess that is why you are here today. Thank you, Mr. Chairman.

Chairman THOMAS. The gentleman is welcome. Does the gentleman from Colorado, Mr. Beauprez, wish to inquire?

Mr. BEAUPREZ. Thank you, Mr. Chairman. I think I will start with you, Mr. Macomber. Am I pronouncing it correctly?

Mr. MACOMBER. That is about as close as anyone ever gets. That is great. Thank you.

Mr. BEAUPREZ. Nobody tries my name ever at all. You have made a case that I think actually is going to invite a response from the Admiral and from Ms. May. But you made a case that credit unions aren't unlike the mutuals of the 'fifties. All credit unions?

Mr. MACOMBER. Credit unions aren't like mutuals of 2005, either. I think the answer to that might be to go back—Mr. Brady had asked a question of Chairman Johnson about could she really quantify or make a real distinction between credit unions and small community banks. She seemed unable to come up with an answer to that, and frankly I am unable to come up with an answer to that as well.

Mr. BEAUPREZ. Well, I wanted to clarify that that is what you said, because I want to come back to the Admiral and Ms. May because my guess is that you have a different perception, and invite you to maybe rebut that at least.

Mr. MACOMBER. If I could add just one quick question.

Mr. BEAUPREZ. Very quickly because my time is——

Mr. MACOMBER. But I am with a mutual savings bank, and our only real source of capital is also retained earnings. We are fully taxed.

Mr. BEAUPREZ. Oh, I heard that. I understand that.

Ms. MAY. Any real differences between credit unions and mutual savings banks?

Mr. BEAUPREZ. Yes, and let me tell where I am going. In my earlier questions, I said I am here to reduce tax burdens on people. I am not looking to raise taxes, and I am very serious about that. But I am also very serious that the credit union industry needs to help us somehow—I think it is a line that the Chairman was following—in defending what the Admiral just used I think exactly the right word, the privilege, of tax-exempt status. I think that is—I think with all due respect to my colleague from Washington, I think that is what this is about is making sure that we can do that.

Ms. MAY. Well, and I certainly acknowledge that it is a privilege to have a tax-exempt status, and I value that highly. You know, when I walk out of my office at any time of the day, and I look at the members that we serve, or when I answer my phone——

Mr. BEAUPREZ. Well, I want to be very specific because I have got limited time.

Ms. MAY. Okay.

Mr. BEAUPREZ. I want to go right to the heart of his question. If we just say because in El Paso, there are poor folks, I understand and accept that.

Ms. MAY. Yeah. In El Paso, I am able to reach out and do things with my members that if I was paying and concerned about paying interest or dividends to stockholders I would not be able to do.

Mr. BEAUPREZ. Okay. I accept that. Admiral?

Vice Admiral DAWSON. Sir, I have no rebuttal. I just—I know what we are as a credit union. We are owned by our members. Our borrowers are our—and lenders are the same people. We are governed by a volunteer board.

Mr. BEAUPREZ. Okay. All right. I accept that. I am going to leave you with but a singular, very personal experience, and tell you that, like we politicians suffer with one bad apple spoiling the barrel and we all get painted, I would submit to you that there is—that is a little bit of the challenge your industry faces. I would submit to you that it is probably incumbent upon your industry again to help us make sure that your privilege is protected. I would like to be able to do that. Here is my very personal experience. I had a daughter who was obsessed a particular little car. She found it in the used car—the want ads. It was about an hour and half away. My wife and she went down to the used car lot, looked at it, negotiated, got a price, and the salesman when they were closing the deal said you need a loan. Well, frankly, she didn't, but her curiosity was up, and she said what do you got. He says, well, the credit union right across the street will take care of you.

Oh, but I am not a member. That is not a problem. There is your problem, Ms. May and Admiral Dawson. That is your problem in that, you know, we had nothing to do with that area, that region, that field of membership, and when you see those kind of circumstances I understand why people like this have concern, and when I wrote down the words equity and fairness, that is our job. On this side of the desk now, I have a different job. It is very much one of trying to provide equity and fairness to all of the taxpayers and those that don't. I submit to you again the challenge for your industry, of which I am a fan and I want to remain a fan, and I want to be as supportive as I can possibly be, is to help us help you demonstrate that we are still continuing to be fair and equitable to everybody that is operating on the playingfield. Thank you, Mr. Chairman. I yield back.

Chairman THOMAS. I thank the gentleman. The gentleman from Louisiana? The gentlewoman from Pennsylvania?

Ms. HART. Thank you, Mr. Chairman. I asked a question earlier of the Association President Chairman I guess, Chairwoman, regarding the transparency issue for credit unions, and just request an answer from you since I really didn't get one from her, Admiral and Ms. May. Is there some objection to providing more transparency in the credit union business? Is there something that I am missing that would present a problem for that industry if they filed the same form, the form 990, with the IRS?

Vice Admiral DAWSON. I can speak for Navy Federal, and I will say that none whatsoever. We want to be transparent. We think that we are. We submit a 5300 report once a quarter to NCUA. That report is available to anyone that wants to see it, not only our members, but anyone in the Nation that wants to see it. We have a—I have an internal audit Committee or audit division that looks very closely at my credit union. We have Price Waterhouse as an outside auditor. In fact, as I speak today, they are on board doing their quarterly audit. I have a supervisory Committee made up of volunteers that can look at anything within my credit union. Transparency is a good thing.

Ms. HART. Okay. Ms. May?

Ms. MAY. As the gentleman from IRS mentioned several times, state-chartered credit unions do file a 990. I am a state-chartered credit union. So, we do file in the State of Texas, and it is filed as a group 990, and then I subsequently file a 990–T.

Ms. HART. Is there information that is disclosed in there that you believe is sensitive that in some way might harm the credit union members?

Ms. MAY. You know, complying with the law and the rules set forth is certainly something that is very important to us. I, like the Admiral, go out of our way to make sure our members—everything possible can be disclosed to our members. I also have the same audit Committee structure, do the same certified CPA audits. They are fully unqualified with—we sign off on the various statements that we have to make to get a CPA audit. There are, in fact—my institution, my staff, and my self go out of our way to over comply with any rule or any reporting requirements. So.

Ms. HART. I didn't get—what is the size of your credit union?

Ms. MAY. One point one billion.

Ms. HART. Okay. Thank you. I would like to ask the bankers a similar question. Do you think it is necessary that they would comply with the same transparency?

Mr. HAYES. Yes, ma'am.

Ms. HART. Tell me why, Mr. Hayes?

Mr. HAYES. Well, you know, I have examiners coming in my bank on Monday. I have had the 30-page questionnaire, and we have completed all that, and I am sure that the credit unions go through that as well. But it is imperative—it is sort of like the report card that your children sometimes don't want to bring home. You know, when you ask them how are they doing? Fine. But until you get the piece of paper that says well, you made a "C." I think transparency is that report card, and I think it is absolutely not a problem for me, and I don't think it should be a problem for anybody, especially if there is a tax advantage that is there.

Ms. HART. I think that is the major point is that people have a suspicion because there isn't a level of transparency, and it may be completely unfounded.

Mr. HAYES. Right. I think they are all very——

Ms. HART. But we can't be sure.

Mr. HAYES. We are all honorable people. But, you know, I think it is just transparency needs to be there, and I think that is important. I applaud these folks that are doing it. But the regulator needs to say, the regulator tells us what we are going to do nine times out of 10.

Ms. HART. Right. Mr. Macomber?

Mr. MACOMBER. I don't really have a different—anything to add to what——

Ms. HART. Okay.

Mr. MACOMBER. —Dave said, except that the FDIC, which examines our bank and is our primary Federal regulator, does have some curiosity about salaries and things in the bank, which doesn't appear to be true for the NCUA.

Ms. HART. Okay.

Mr. PLAGGE. The only comment I would make: It really struck me in the first panel of just how an entity that is there for the public good has literally no reporting to do, period—I mean as it relates to CRA, as it relates to those kind of things that would prove the marketplace that they serve there seems to be no push from the regulator, who is supposed to be doing that, as OCC does with our bank, to actually accomplish that. That is probably the biggest frustration. If everybody followed the best practices that we just hear to the right, that is probably not—you know, it is probably a lot less conversation.

Ms. HART. That may be the case. Ms. May, do you want to respond?

Ms. MAY. I just want to say a CPA audit is a requirement.

Ms. HART. Yes.

Ms. MAY. There is no way around that. The audit by the examiners, by the regulator occurs every year, and, yes, they do ask my salary and the salary of my management staff. There is no hiding of any facts in that sense. We do also report HMDA information. The only report that we don't make is the CRA report. We do everything else that has been alluded to. Quite honestly, I assume the mutual savings were reporting 990 during the S&L crisis.

Ms. HART. Thank you. I am out of time. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentlewoman. Does the gentleman from Tennessee, Mr. Tanner, wish to inquire?

Mr. TANNER. Thank you very much, Mr. Chairman. And, Mr. Hayes, thank you for being here. He is from the great eighth district of Tennessee, and we appreciate your coming to Washington today.

Mr. HAYES. Thank you, sir.

Mr. TANNER. Most of the questions that I had have been asked. Are there any meaningful restrictions on credit union membership? In other words, is there—if Mr. Beauprez's daughter can join a credit union across the street with no connection to that area or anything, what are the meaningful restrictions on credit union membership and who sets them?

Vice Admiral DAWSON. Unfortunately, his—I don't think his daughter could join my credit union. I would like her to, but she would have to join the Navy or the Marine Corps first. We are always looking for a few good folks. So, yes, I have restrictions on my field of membership, which is the Department of the Navy active duty military sailors and marines and civilians that work for the Department of the Navy. I have restrictions.

Mr. TANNER. Could I just add something here? But the membership, and let me preface my remark by saying I spent 22 years in the Navy. I was once a member of the Navy Federal Credit Union, and have a great deal of respect for everything the credit union does. But the credit union membership rules are not just members of the military, but their spouses, their mothers, their fathers, their grandparents, and then it can go out from there. By the six—if you remember the movie, "Six Degrees of Separation," you could take on just about anybody in the country. There are 2.5 million members in the Navy Federal Credit Union. That is not a criticism of the credit union. But I think it shows you how the membership can be just expanded. This is the first time I have ever taken issue with an admiral in a public forum.

Vice Admiral DAWSON. No issue there. Did you keep your membership?

Mr. MACOMBER. I did not get my membership.

Vice Admiral DAWSON. But unfortunately, if you had applied again, you couldn't become a member; is that is the restriction that I have so.

Mr. TANNER. Do you set that or does the—are you a Federal credit union—who sets the membership guidelines? Is it left up to individual credit unions or is it——

Vice Admiral DAWSON. No. No, sir. You apply for your field of membership with our regulator, NCUA, and they determine what your field of membership can be.

Mr. TANNER. Well, I was just wondering what the field of membership is for your daughter.

Mr. BEAUPREZ. I don't know what the field of membership was Mr. Tanner, but the question that we asked was, how do we become a member. Oh, all you got to do is walk in and sign the form. If you wanted to be a member, in other words, my wife was told, you are a member. That is all you needed.

Mr. TANNER. Is that because we all have a body temperature of approximately 98.6? I assume we do at least unless somebody up here is dead.

Chairman THOMAS. Will the gentleman yield? Apparently, that is variable as well.

[Laughter.]

Mr. TANNER. Thank you, Mr. Chairman.

Chairman THOMAS. Does the gentleman from California wish to inquire?

Mr. BECERRA. Yes, Mr. Chairman. Thank you. Let me see if I can ask a question that Ms. May posed or she made a comment that I am hoping folks from the banking industry might respond to. She indicated that she had an application for credit union status with her. Can you give us your explanation of why more banks or mutuals have not converted to credit unions if the credit unions have it so good?

Mr. PLAGGE. First National Bank in Waverly is a 141-year-old small business. It is a small banking institution. It's part of the American fabric of small business. There are non-profits. There are for-profits. There are publics. There are privates. I guess the question in itself, if the world was made up if not-for-profits, non-taxpaying, tax-exempt entities, it doesn't work. Again, our argument isn't against the industry itself, the credit union industry itself. It is those that—that it made a comment here several times before—that seem to have no limits on what they can do. It seems to frame around NCUA that has no borders on what they will approve for a community charter for a common bond for business and products and services. You are seeing exceptions here with the large credit unions that are staying to task, that are staying to a membership field common bond, which is terrific. But that is not what we are seeing on a nationwide basis as it relates to business lending and so forth. So, I am not apologizing for our status as a community bank in Waverly, Iowa, 141 years old, owned by our community and employees. So, that is not an option we would chose to take.

Mr. BECERRA. I think that is a great response, and before I move to anyone else, let me do that—is it Plagge or Plague?

Mr. PLAGGE. Plagge.

Mr. BECERRA. Plagge. Mr. Plagge I think makes a good argument here that you can have any number. His concern is not with any credit union. It is those that seem to be going beyond the scope of what the charter was meant to provide to any credit union. To those of you who operate credit unions, two questions: Is there ever a point where you get too big? Second, should you be allowed to get bigger when you still—or at least some or the credit unions in the industry still don't seem to be providing service to a lot of the modest-income families that you would think that credit unions would be best at serving?

Ms. MAY. Congressman, when 1151 was passed in 1998, that made available to credit unions the opportunity to expand beyond their traditional fields to add low-income areas. In adding low-income areas, we have seen I believe Ms. Johnson reported three times the growth among those credit unions than we have in the credit unions that did not add low-income areas. As a credit union grows and reaches out and serves more people of modest means, I think that is a success factor, and that is an opportunity to bring more services to people who otherwise are unbanked.

Mr. BECERRA. So, Ms. May, if I could ask you there: At what point will you be able to come back to us and say you at least match the banks when it comes to providing loans, mortgages, or otherwise to folks in modest income communities to the level that banks do?

Ms. MAY. Are you speaking of GECU or are you speaking of credit unions as a movement?

Mr. BECERRA. As a whole.

Ms. MAY. As a whole.

Mr. BECERRA. Because obviously, as I think Mr. Plagge pointed out, there are some exceptions or perhaps they are the rule, but they are concerned more with the outliers.

Ms. MAY. Well, we are already seeing in the HMDA data an improvement year by year.

Mr. BECERRA. But I am asking at what point do you think the industry, the credit union industry, will at least as an industry come to the point of matching the banking—the for-profit industry—when it comes to making loans to modest-income families in this country?

Ms. MAY. Well, I would suspect we are already there or above it.

Mr. BECERRA. Okay. I am not sure if the data are out there, but I am not sure if that is the case. I would hope that that would be the case because that would certainly move forward in lending you a lot more support. I think I stopped is it Mr. Hayes?

Mr. HAYES. Yes, sir. You know, like Mr. Plagge, I mean we—you know, we have been around for 75 years, and we have been there because we have served our customers, all levels of customers, from low to moderate to those who have resources. As I have traveled throughout the country representing the ICBA and the 5,000 member banks—we represent 6 percent of the total banking assets, and we are—you know, we pay taxes. I think it gets to be an issue to us is just, you know, it looks like it is not fair. And, you know, you shouldn't even be asking the question if the charter was to serve the low and moderate, and, yet, you are having to ask the question when are they going to be there, I mean if that was the charter, that was what was put forth. I think it is ironic that we are even asking the question.

Mr. BECERRA. Thank you very much.

Chairman THOMAS. The gentleman's time——

Mr. BECERRA. My time has expired.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from North Dakota wish to inquire?

Mr. POMEROY. I did, Mr. Chairman. I thank you for this hearing. I think it has been a very interesting discussion. I am not quite sure where all of this is going, but if we are just in a kind of expansive, fact-gathering position of the Ways and Means Committee, I have found this to be a quite an interesting discussion. I might suggest, Mr. Chairman, that a hearing similar on pensions would be extremely timely. It is just an enormous amount of concern in this area, and a lot of misinformation in this area, too. Even having the discussion about it, absent any particular legislation might be something that would be a good pursuit for this Committee. But as to the issue before us——

Chairman THOMAS. Would the gentleman yield?

Mr. POMEROY. Yes, I will.

Chairman THOMAS. I think I have a thick enough skin for that. [Laughter.]

Mr. POMEROY. I reckon you do.

[Laughter.]

Mr. POMEROY. I would just have a couple of questions. It is a bit off the topic, but I have been concerned about, and as long as we have the Navy here, Admiral, I have been concerned about the location of these payday lending outfits and these subprime outfits and even the—I used to be an insurance commissioner—the marketing of scurrilous insurance products to the men and women in our military. I think that for the favored tax status of credit unions, we do have a right to expect a measure extra, and investment back in the members. So, I am interested in what you can tell us about Navy Credit Union's effort to really help your membership steer its way through and around that subprime industry.

Vice Admiral DAWSON. We do a variety of things. We make our—we make services available to the bases where we serve, to provide education on finances for young sailors and marines. I have a very large budgetary counseling division at Navy Federal that people can call in to get counseling, and they work with a lot of people that—or a number of people that have gotten in trouble with payday lenders. I think of payday lending for—as a spiral of doom for sailors and marines. It is something they just can't recover from. We all must bring forth alternatives to that. We have worked with the Navy-Marine Corps Relief Society. We have talked to them about how we can bridge the gap between when people arrive at their doors who are destitute, many of them because they have just gone on the shoals from payday lending.

Mr. POMEROY. I appreciate that response, and I—in the event there are Federal legislative issues that you think we actually ought to pursue, relative to market abuse in this area, the Committee would I am sure appreciate having it called to your attention. Generally, it is a regulatory issue dealt with at a state level, but it does concern me a lot. I mean those who would prey upon men and women in our Services, and it is despicable conduct. More generally, on this—look I have got friends on both sides of this issue, and I have spent a lot of years with my friends in the North Dakota banker community talking about the words you used, Mr. Macomber, an impending crisis. There is no doubt they feel like they can't compete against these non-taxed entities, and they are deeply anguished about it, sincerely so. For me trying to evaluate how all this sorts out, I tend to think market share is the ultimate demonstration of whether or not we have got something here that indeed has given somebody a clear and non-competitive advantage in the marketplace. Now, I would like the bankers on the panel to tell me how you—to me it looks like the market share is staying relatively stable and that profits are healthy in the banking sector, and that diminishes my concern that we are heading toward an impending crisis in banking. I don't say that to be argumentative. I would just like your response, sir.

Mr. PLAGGE. Well, I think it is a great question, because I just refer back to something David just said. You know, the community banking sector represents 6 percent of the financial sector. Interestingly enough, that is the same percent as the credit union. The credit union industry tries to do I think a great job, and it has been very successful at it—doing—making this the discussion about Citi Group or Citicorp against small credit unions, when, in fact, the real battle lines are on the local level against large credit unions and community banks. One tax study in Virginia said that there is a 67 basis point difference—benefit to the credit union either on the loan side or the borrowing—or the deposit side. If that indeed is the case, and whether it is that amount or a little less, whatever. Just take the tax rates and look at it as a whole. If we are all community-based, and we all know our customers, we are all offering essentially the same products and services, 67 basis points is a huge difference. Because it is an exemption that goes into that marketplace, I mean competition isn't competition. It is not level playingfield competition. The tax-exemption gives enough benefit in rates and terms that it can move the market in that direction, which is what we are seeing happen in community bank marketplaces.

Mr. POMEROY. Well, I mean that is just a question. I mean I know the argument. It has been well advanced and often today.

Mr. PLAGGE. Right.

Mr. POMEROY. But what is happening in market share relative to community banks?

Chairman THOMAS. The gentleman's time has expired. Any of these questions that are asked in which time runs out, if any panel member of any panel wishes to supply in writing additional information to explore this area, because I do think share of overall pie versus concentration within a share of the pie is something that I think needs to be talked about completely. Does the gentleman from Indiana, Mr. Chocola, wish to inquire?

Mr. CHOCOLA. Thank you, Mr. Chairman. Thank you all for being here today. At the risk of stating the obvious, I think we all, obviously, understand that credit unions' tax-exempt status is based on their unique organizational structure and their goal of operating for mutual purposes, serving under-served areas and populations. So, I guess the purpose of being here today is to answer: Do you do that? Maybe to help us answer that, we can look at the state I come from, which is Indiana. The Federal Reserve has estimated that a minimum profitable loan is about $2,400. There was a survey done this year in Indiana that indicated that 41 credit unions were randomly surveyed, and it found out that the average minimum loan for these credit unions was $281.

It also found out that no-cost checking in these credit unions was offered on an average of a $17 balance in the checking account. Also, 26 percent of their members had checking balances under $100; and 55 percent of the savings account balances in these credit unions were under $250. So, I guess for the credit union representatives, I would ask, is this unique to Indiana? Or is this a similar experience that you see in your state and industry-wide? In the interest of full disclosure to the community bankers, I was part of a group that started a series of community banks in Indiana. Is this the kind of business that you solicit and want? Do you see this as potentially profitable? So, I would ask the community bank representatives, first, is this unique to Indiana, or is this what you see industry-wide?

Vice Admiral DAWSON. I think we see it across the credit union industry. At Navy Federal, in 2005, we have a quarter of our loans average $1,600. Also, as you mentioned, checking, we not only have free checking, we pay interest in checking. And 20 percent of our checking accounts have $100 balance or less at the end of the month. So, they not only get free checking for that, they get interest on that, as well. I don't think we are unique in the credit union industry.

Mr. CHOCOLA. Ms. May?

Ms. MAY. While I don't have the exact numbers with me, he is absolutely right. Indiana is not unique. Our 247,000 members, the average balance overall is $4,000 in their deposit accounts in total. In a financial cooperative, you have those who have, and those who don't have. So, it takes a few very large depositing members to make available the moneys that we can lend out to those who don't have. We make $200 loans on a regular daily basis. We make loans for eyeglasses, for dentures—whatever it takes to improve our members' lives.

Mr. CHOCOLA. Are those profitable loans?

Ms. MAY. No. Our tax-exemption allows us to make those loans. There are a number of loans that we make that are not profitable. We participate actively in a bond program in our city, and there is no profit in those loans, either; but we are able to put a good number of people, first-time homebuyers, into homes. Twenty-six percent of the mortgage loans we made last year were for first-time home buyers. We put out over $3 million just in bond money, which is low-interest downpayment assistance money. The tax-exemption does allow us to do business the way we are able to do business, to help our members—our members, your constituents.

Mr. PLAGGE. Our bank offers the same things: free checking, free ATM, free money markets, free Internet banking, all those kinds of things. We do small loans. We do a variety of direct loans, credit cards, home equity lines, all those kinds of things the same way. We are not unusual in the community banking industry. As an industry, though, there are lots of statistics out there that the credit union industry actually has a higher-wealth membership than our customer base is in the community banking world. There are plenty of studies to show that as well again, and I think it is actually part of my testimony.

Mr. MACOMBER. There is no one here that is running a private bank. We are taking customers regardless of their background. Again, the statistics that came out, there was a survey I mentioned earlier that goes back to 2003 that indicates that small community banks do a better job of serving low- and moderate-income individuals than credit unions do. So, I think you can focus in on certain statistics, but I think that is pretty much where we are. I think everything we have heard today from the industry, from the credit union industry itself, supports that position.

Mr. HAYES. We are community bankers. That is our community. I mean, that is who our customers are. When you have $8-, $10-an-hour jobs that you worked hard to bring into your community, I mean, you are going to take care of those people. Having been in a community bank, I believe you understand that those customers that we all probably have are similar. There is just one difference.

Mr. CHOCOLA. Well, thank you. I yield back, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. Does the gentlewoman from Ohio wish to inquire?

Ms. TUBBS JONES. Thank you, Mr. Chairman. I always am in amazement, having sat as a judge for about 10 years, when I bring people into my chambers for pre-trial discussion. I say, "Plaintiff, tell me what is going on," and I say, "Defendant, tell me what is going on." I realize I have to wade through all of it to understand, myself. I am always amazed at why one or the other of the financial institutions in this community seem to think they are better than the other, or they are at a disadvantage, or whatever. But I understand the next thing on the loom is when Wal-Mart gets to become an industrial bank.

Mr. HAYES. Yes, ma'am.

Ms. TUBBS JONES. All of you are going to be at my desk, telling me, "Don't let it happen," right?

Mr. HAYES. You don't want to get me started on that.

Ms. TUBBS JONES. Don't get you started, huh?

Mr. HAYES. How long do you have?

Ms. TUBBS JONES. All right, I'll just ring a bell in the room here.

[Laughter.]

Ms. TUBBS JONES. I really think, Mr. Chairman—and I would suggest this—that there might be a forum in which we might be better able to have a discussion like this—because members are restricted to 5 minutes—if there are truly issues that anybody needs to address to make themselves stronger in the job that they do. Clearly, our goal is that our constituents are served, no matter what institution it is that is in our community. We all really want to try and be supportive. Maybe there is a forum in which we could literally sit down, maybe with all the credit unions talking about what it is we see, or they need to do, or with all the community banks, with all the other ones. Then maybe try and bring them all in the same room—without boxing gloves—and have a discussion about finances in America. I thought I would ask another question, Mr. Chairman, but I know, like all of my colleagues, we are probably at the end of questions. I just put that on the table as a possibility that we might engage in down in the future. Also, it makes it not seem as if there is an environment operating here to support or not support any institution. I yield back the balance of my time, Mr. Chairman.

Chairman THOMAS. Thank the gentlewoman. The problem in part is that it depends on how you ask the question, as to what you get in answer. If are a common bond union and you belong to a corporation and everybody is employed, then you don't have extremely low-income, as people would define low-income. But you also oftentimes don't have very high income. So, on average, you may be higher than someone else, or in fact you may not be. When you talk about including under-served areas, that doesn't mean that you are necessarily serving people who are low-income in the under-served area; unless, of course, you can produce the data that shows that. Part of the discussion has been that, unfortunately, in the Chair's opinion, the agency that is created to oversee the structure seems to not understand that the ability to produce data is a very positive thing which can make a point and which provides an early warning system if in fact certain things are going in particular directions. It seems to be that the people are more comfortable simply saying "I believe, and therefore it is." Now, in some instances, you can get an answer that shows you how comfortable people are when they say "I believe." Vice Admiral Dawson, you folks, what is your structure? Common bond, multiple bond?

Vice Admiral DAWSON. Common bond.

Chairman THOMAS. You are a common bond. Now, we have gone a little out of the color marks of Navy. It is navy family, even if they are civilians; but it is on bases, so you are looking at Navy. You are enormous in size.

Vice Admiral DAWSON. Navy and Marine Corps, yes, sir.

Chairman THOMAS. Navy and Marine Corps together. You have got to include those. But you are enormous in size. But you have a common thread which I think is fairly clear, but you extend it to families.

Vice Admiral DAWSON. Yes, sir.

Chairman THOMAS. How far out does the family tree go? Obviously, husband or wife.

Vice Admiral DAWSON. Husband or wife.

Chairman THOMAS. Obviously, children.

Vice Admiral DAWSON. Children, mothers.

Chairman THOMAS. Mothers.

Vice Admiral DAWSON. Yes. My mother is a member.

Chairman THOMAS. Well, therefore, fathers, I assume.

Vice Admiral DAWSON. Fathers, yes.

Chairman THOMAS. Okay. Is that it?

Vice Admiral DAWSON. Yes, sir.

Chairman THOMAS. Ms. May, you folks have decided to take it one more jump; is that correct?

Ms. MAY. That is correct. We were originally Federal Civil Service workers and their family members.

Chairman THOMAS. But that was a common bond.

Ms. MAY. That was a common bond.

Chairman THOMAS. But you are not a common bond any more?

Ms. MAY. We are now a community, the El Paso County.

Chairman THOMAS. Right. But you are also under the state structure, right?

Ms. MAY. I am also under state structure.

Chairman THOMAS. Yes. You are state, and he is Federal.

Ms. MAY. That is correct.

Chairman THOMAS. Yes. But you don't just stop at mother, father, sons, and daughters. You include——

Ms. MAY. Pretty much everybody in El Paso County is related, so that pretty well handles my community.

[Laughter.]

Chairman THOMAS. Is that why you decided to go to first cousins?

[Laughter.]

Ms. MAY. Well, you know, first cousin really was—that is pretty far out there.

Chairman THOMAS. But you cover first cousins.

Ms. MAY. We cover first cousins.

Chairman THOMAS. If someone comes in and says, "I am a first cousin——"

Ms. MAY. But typically, they qualify because they live in El Paso County. We only have offices in El Paso County.

Chairman THOMAS. You clearly serve under-served areas.

Ms. MAY. Absolutely.

Chairman THOMAS. Do you believe that if you are now going to respond to an under-served area, and you put an ATM in there, that that really meets the financial services of an under-served area?

Ms. MAY. I can only respond for GECU.

Chairman THOMAS. That is why I am asking you.

Ms. MAY. We have placed offices—12,000-square-foot building—in, I'd say, the southeast side of El Paso, which is primarily Hispanic. In fact, every sign we have in that office, every brochure we have in that office, is in the Spanish language. This is what I would consider an under-served area, and it is a very successful branch. We are very proud of what we do in that branch.

Chairman THOMAS. Don't you find, though, that if you are really going to try to service an under-served area, one, you probably have to have a facility, because they are not as knowledgeable about the way things work; you have to have people who speak their language; and the counseling has to be far more supportive than it would be in an non-under-served area?

Ms. MAY. In my city, that is true.

Chairman THOMAS. Yes.

Ms. MAY. As I say, we are Hispanic. It is face-to-face, mano-a-mano. We speak the language, we share the common culture, quite honestly.

Chairman THOMAS. But you are saying that probably an ATM would not——

Ms. MAY. Not in my city.

Chairman THOMAS. —satisfy?

Ms. MAY. No, sir.

Chairman THOMAS. That is why I find it interesting that there has been an attempt to move ATMs as satisfactory in under-served areas. That seems to me to be looking at outreach far more similar to these fellows over here, who are driven by the profit motive, by which we temper that with taxes, because all they want to do is just make money. The credit unions don't want to just make money; they want to serve an area. But it seems to me, as I said, ATMs, period. Admiral, have you ever discussed going beyond the common bond in terms of structure; multiple bond or community?

Vice Admiral DAWSON. No, sir, not at our credit union.

Chairman THOMAS. I mean, if you push this community thing anywhere a ship sails, you guys have got a pretty interesting territory.

[Laughter.]

Vice Admiral DAWSON. Girlfriends are not permitted to join.

Chairman THOMAS. Okay. Ports of call, I mean, you know.

Vice Admiral DAWSON. Girlfriends are not permitted to join.

[Laughter.]

Chairman THOMAS. Now, I am going to ask you, and I am going to ask Ms. May, and I know it is difficult because you are here representing organizations, and not yourselves, and you may not want to answer this question. If you choose not to, I understand. Ms. May, you saw a need in the community, and so the community concept and outreach with the state structure made sense to you.

Ms. MAY. Yes, sir.

Chairman THOMAS. Do you have any minor discomfort about the concept that a geographic or community structure would include Los Angeles County, with all of the rich and the poor and the millions of people?

Ms. MAY. I guess my simple response to that would be, a credit union is a financial cooperative. In order to have a cooperative, you have to have those who have, and those who have not. Those who have make deposits, so that those who don't have can borrow moneys.

Chairman THOMAS. That wasn't my question, but I understand the difficulty you would have in answering a question like that. Based upon the way you answered it, I really thank you very much.

[Laughter.]

Chairman THOMAS. Vice Admiral, do you get any qualm at all about an area which is supposed to be local that has a population greater than 42 states?

Vice Admiral DAWSON. Sir, I have just been aboard 11 months. I would have to look at what that is all about. I am not familiar with that.

Chairman THOMAS. You see, I think you are comfortable and people are comfortable with you because, in essence, it is Navy family, or people who are close to Navy family.

Vice Admiral DAWSON. Right.

Chairman THOMAS. So, you feel comfortable with that; notwithstanding the fact that you are millions, and have got billions. But there is a comfort level based upon that nexus. I am just trying to get my arms around the nexus of LA County. That is part of my problem. But I appreciate your narrow answer—which could have been different, and wasn't. So, I appreciate it very much. Does the gentleman from New York wish to inquire?

Mr. RANGEL. I just wanted to thank Ms. May. I have heard that just her presence here and her presentation has made you a very pleasant Chair here and changed the whole atmosphere——

[Laughter.]

Chairman THOMAS. Oh, not at all.

Mr. RANGEL. Well, I just heard that, so let me say——

Chairman THOMAS. It was actually the fact that you were gone.

[Laughter.]

Mr. RANGEL. Okay. Ms. May, I just want you to know that I may be calling you from time to time——

[Laughter.]

Mr. RANGEL. You know, just to just be here and sit here and be your pleasant self.

[Laughter.]

Mr. RANGEL. Let me thank all of you for making it possible that we understand the problem better. Thank you.

Chairman THOMAS. Thank you. Let me say, if you understood the discussion on the first panel, that the fear that we are simply out as a cash cow to find money where people aren't paying taxes should not be thought of as the particular thrust. Our concern is with how a changing structure, not justified or documented is fulfilling its responsibilities. Obviously, Ms. May, in the basis of how you grew up and what you did and where it is, that is the kind of thing that is documented. Then the question is, "Okay, so why?" That is a second decision. But given the structure movement with definition and obviously displayed by small bankers who I think partly have some envy of the loans made to these massive buildings and major companies, which is something they would be desirous of—does that really focus on a mission statement? But to the extent that the mission statement is seen totally as the organization or the structure of the organization doesn't focus on the social assistance aspect to it, I do believe we have a problem because the lines are getting blurred. That is where we have to spend more time focusing on that line to get it clear; rather than what I think is a blurring which generates a degree of criticism, which in part has led to this hearing, but which also is simply something systematically this Committee needs to do under the oversight structure.

We let people do what they do without paying taxes. Periodically, we have to stop by and say, "How are things going? Because I have got people who are paying taxes, and they want to know why you don't pay taxes." That is what this hearing is all about. Thank you very much. If we will have the third panel, I want to thank the third panel for their patience. But apparently, I don't have to, because the first name on the third panel is someone who is very familiar with the way this place works. It is a pleasure to have before this Committee a former member, a former colleague, a former Representative from New Hampshire, Norm D'Amours. We have Gordon V.—is it Karels?

Dr. KARELS. Karels.

Chairman THOMAS. Karels, thank you, Karels, who is the Associate Dean, College of Business Administration, at the University of Nebraska; John Taylor, who is the President and Chief Executive Officer of the National Community Reinvestment Coalition; and Constance Kennelly—"Kennelly"? It is pronounced "Kennelly"? I thought it was "Kennelly," but they put it "Kennelly," because we had a former member of the Committee who we had as "Kennelly." Of Tulane-Loyola Credit Union in New Orleans, Louisiana. All of you have submitted written testimony. It will be made a part of the record. During the time that you have, you can address the Committee as you see fit. If you will allow me, I will start with our former colleague, Mr. D'Amours.

STATEMENT OF HON. NORMAN E. D'AMOURS, A FORMER REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW HAMPSHIRE; FORMER CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Mr. D'AMOURS. Thank you, Mr. Chairman and Ranking Member Rangel, Members of this Committee. I am here today, at the request of this Committee, to offer my perspective on the performance of credit unions in serving low-income Americans, as they were dedicated to do by their founders, their history, their traditions and, very importantly, by the U.S. Congress in the 1934 Credit Union Act and the 1998 Credit Union Membership Access Act. In my opinion, the majority of credit unions are holding true to their mission of focusing on low-income members and potential members. However, this majority controls a relatively small minority of the total assets of the credit union system, and this majority has little or no voice in setting the direction and priorities of the overall direction of the credit union system. The founders of the credit union movement insisted that unpaid volunteers would control a not-for-profit system, run on sound business principles by people who were not out for personal enrichment, and who would focus on low-income Americans.

The reality today is that a small minority of large credit unions have created a tightly-controlled and intimidating structure, controlled not by volunteers, but by professionals who pursue growth for its own sake, and who profit quite handsomely from that growth. Those in control are uncomfortable with, and even at times in denial of, the traditional credit union obligation to focus on low-income people. They fear there is just not enough profit in that. When I was Chairman of the NCUA, I attempted to refocus the system on low-income credit unions and low-income people who belong to those credit unions and to other credit unions. That effort was resisted by the major credit union trade groups and by some larger credit unions. Also, as Chairman of NCUA, I tried to effectively measure the performance of credit unions in serving low-income people. Those efforts were defeated by the NCUA board because of strong opposition by trade groups and some credit unions.

There have been several objective studies over the past six years providing substantial evidence that credit unions as a whole are not serving low-income people adequately. These studies, by Dr. John Caskey of Swarthmore College in Pennsylvania, by the Woodstock Institute of Chicago, by the GAO, by the National Community Reinvestment Coalition, conclude that in many cases banks serve more low-income Americans than do credit unions, and credit unions aren't sufficiently focused on low-income people. You can ignore these studies if you choose to, but they are there. There is also strong evidence that, while touting their performance in serving low-income people, some credit unions and their trade groups fiercely resist any meaningful effort to effectively measure that performance, just as they did when I was Chairman of NCUA.

Mr. Chairman and Members of the Committee, I am not here to suggest that credit unions should lose their tax-exemption. However, as both a taxpayer and a strong supporter of credit union ideals, I do think credit unions should be held accountable for their tax advantages that they are provided. This tax advantage is based on the traditional focus of credit unions on people of small means. Congress needs to mandate and oversee measurable standards requiring credit unions to focus on serving low-income Americans. This effort is going to have to come from this Committee and from this Congress. It will surely not come from the current credit union structure, and it will not come from the NCUA. A good first step might be an effective survey of credit union performance in serving people of small means. That action might begin the process of injecting needed transparency into a closed system. The Woodstock Institute study, by the way, in 2003, did suggest other steps that perhaps this Committee could look at.

Lacking strong congressional direction, I believe it is a virtual certainty that the credit union system will continue to veer further and further off course, and this to the great detriment of low-income Americans and to America itself. Mr. Chairman, there are hundreds and hundreds of small credit unions out there greatly in need of assistance. They aren't getting that assistance; meaning their low-income members aren't getting the help and assistance that they need. I hope this Committee will, after this hearing, follow up and see to it that the steps we have discussed, and that I have mentioned in my written testimony, and that the Woodstock Institute outlined, will be considered. I thank you for your attention. I will be glad to answer questions, when the moment arises.

[The prepared statement of Mr. D'Amours follows:]

Statement of Hon. Norman E. D'Amours, a former Representative in Congress from the State of New Hampshire, and former Chairman, National Credit Union Administration

Mr. Chairman and members of the Committee, I am here today at the request of the Committee to comment on the performance of credit unions in serving low income people who belong to a credit union or are within its field of membership.

I have had the opportunity to observe credit unions from various perspectives for about thirty years. I served on the U.S. Congressional Financial Services Committee (then called the Banking Committee) from 1975 to 1985. After leaving Congress in 1985 I was hired by the Credit Union National Association (CUNA) as a legislative lobbyist and acted in that capacity until 1993. In that year, I was confirmed by the

U.S. Senate to the Board of the National Credit Union Administration (NCUA) which regulates and/or insures almost all of America's credit unions. I was immediately appointed chairman of that Board and served in that position until I left the NCUA in December of 2000.

I have been informed that the purpose of today's meeting is to address the concerns of some Committee members that credit unions may have strayed from their traditional mission of serving people of small means, meaning low-income people, as that mission is imposed upon them in the preamble of the 1934 Credit Union Act and re-imposed in the 1998 Credit Union Membership Access Act.

Credit unions were introduced into the United States in the early part of the last century through the efforts of wealthy department store owner Edward Filene, Massachusetts banking commissioner Pierre Jay, Massachusetts attorney Roy Bergengren, Monseigneur Pierre Hevey from my hometown of Manchester, New Hampshire and other leaders who were united by their desire to bring fairly priced financial services to lower income people.

These early credit union movement leaders strictly insisted that credit unions should not be based upon a profit motive. They were adamant in their belief that unpaid volunteer directors of credit unions would govern the operations of financially sound institutions with no thought of personal financial benefit and based on sound business principles. They intended credit unions to work together as cooperatives to help instill habits and values of thrift and prudent borrowing to people who were not financially sophisticated and who did not have access to the mainstream financial institutions of that day. These were the Americans targeted by financial predators. Their efforts helped countless Americans find their way to financial solvency and independence.

The underlying realities that led to the formation of credit unions are very much in existence in today's America. Credit unions are still very much needed to carry out their traditional functions. It is not only the low-income members of credit unions who are helped by traditional credit unions. The American free enterprise financial system benefits when more and more Americans are empowered to join the financial mainstream by breaking the shackles placed on them by predatory lenders. By admitting them to membership in credit unions, low-income people immediately acquire an ownership stake in their institution. They benefit from higher returns on their savings and lower interest rates on their loans because of the credit unions unpaid directors, its not for profit structure and, of course, its exemption from taxes. I am told that there are a few credit unions that still give periodic or end of year dividend bonuses and interest rate rebates to their members when the credit union has had a good year. This practice is not remotely as common today as it once was for reasons I will touch on later.

Mr. Chairman and members of this committee, I am convinced that the credit union philosophy espoused by the movements founders is a beautiful thing. It is consistent with America's promise of self-empowerment. It is consistent with the American dream of the accumulation of assets and wealth that gives our citizens the sense of pride, accomplishment and independence that in turn makes our country stronger.

I come to you speaking as someone who is deeply committed to the traditional focus of credit unions on low income Americans. It is from that perspective that I can assure this committee that its concerns about credit unions having strayed from their mission are not misplaced. They are very well grounded in reality. In fact, there are many people both within and outside of the credit union community who share that concern.

During the seven years that I was at NCUA, I made several efforts to position that agency to pay more attention to small credit unions and low-income credit unions. Such credit unions are more apt to be made up of low-income members. Those efforts were surprisingly difficult to advance because of strong resistance from credit union trade groups and some credit unions.

In 1997, I attempted to persuade the NCUA Board to approve a requirement that community based credit unions should include in their business plans a short statement of the general efforts they would make to serve and reach out to low income members of the community they were chartered to serve. This modest and reasonable effort was also strongly resisted by the major credit union trade groups. In October of 2000, after several permutations, it finally passed as the Community Action Plan (CAP). I left the NCUA at the end of 2000. The NCUA Board repealed CAP in December of 2001 just weeks before it was to take effect.

In 1999, Dr. John Caskey, of Swarthmore College in Pennsylvania, conducted a study of full service credit unions. Dr. Caskey concluded that many and perhaps most of those credit unions were not making efforts to reach out to low income Americans. Dr. Caskey also concluded that while some credit unions were making stellar efforts to serve people of modest means, many others were "free riding" on their backs.[1] That is, they were benefiting politically from the efforts of those staying true to the traditional credit union philosophy while avoiding the responsibility to do so.

In 1999, I sought to measure the performance of credit unions in serving low income persons by having the NCUA approve a survey to evaluate how credit unions were reaching out to underserved members or potential members. The NCUA Board did approve that survey but over my strong objections they voted to make it a voluntary one. The survey was never sent out to credit unions because the Office of Management and Budget (OMB) weighed in to agree with my stated contention that a voluntary survey amounted to a self-selecting sample and would produce no useful data.

In 2002, the Chicago-based Woodstock Institute conducted a study of credit unions that concluded credit unions were not living up to their traditional values and responsibilities toward low income people.

In November of 2003, the U.S. Government Accountability Office (GAO) issued a report on credit unions that made three rather startling points. First, they found that banks were outperforming credit unions in serving low-income people. Second, they found the differences between banks and credit unions were attenuating. Third, they suggested that criteria should be developed by NCUA to measure credit union performance in serving low income Americans.

Earlier this year the National Community Reinvestment Coalition (NCRC) released a very detailed study demonstrating that bankers, because of their Community Reinvestment Act obligations, were outperforming credit unions in serving low-income households and individuals.

Thus, it seems clear that there is considerable evidence that today's credit union system is not dedicating its substantial assets and skills to serving low-income people, which is its traditional, philosophical mission and statutory purpose. It also seems clear that the leaders of the credit union system today do not want credit union performance in this regard to be measured in any meaningful way. Their reaction to the 2003 GAO report was that it was "outrageous" and they implied that GAO was biased.

My personal answer to the question of whether credit unions have strayed from their traditional mission would be that the majority of credit unions have not. However, the reality is that the majority of credit unions control only a relatively small percentage of credit union assets and do not play a significant role in determining the direction of the credit union system as a whole.

According to the 2003 GAO study, credit unions with over one billion dollars in assets account for 28 percent of all credit union assets but for less than 1 percent of credit unions. Credit unions holding over $100 million in assets account for 75 percent of total credit union assets but only 11 percent of all credit unions.

In my opinion, it is this fundamental imbalance between the majority of credit unions and the majority of credit union assets that is root cause of the growing disconnect between traditional credit union philosophy and the systemic credit union resistance to serving low income people. It also helps explain the very harmful and systemic drift towards growth for its own sake and the increasing competition between credit unions within what was once a once more cooperative structure.

The structure within which credit unions are operating is very tightly controlled, from the top down, by profit motivated professionals who seem to be pushing credit unions to grow just for the sake of growing. That is not a natural way for credit unions to grow and can result in a deterioration of services provided to members, especially those of low income. A credit union's surplus will not be returned to the benefit of its members if, only for the sake of growing, those surpluses are dedicated, for instance, to pushing new loan products (that may, perversely, discourage the thrift credit unions were by tradition and statute directed to promote); if they are dedicated to contracting with outside vendors for products that increase income from fee charges; if they are dedicated to acquiring smaller credit unions; if they are dedicated to paying top salaries and bonuses to management, and so on.

While there are many legitimate and natural reasons for credit unions to grow, growth for its own sake is driven in large part by the understandable inclination of professionals who control credit unions to overly focus on higher and higher salaries and bonuses as opposed to serving low income members and potential members. This focus on growth, income and profit seems to apply both to the professionals who manage such credit unions and those who run the trade groups they belong

[1] *Credit Unions and Asset Accumulation by Lower Income Households*. Filene Research Institute. July, 1999, P41

to. That linkage results in a powerful control bloc that is pushing a systemic growth for growth's sake in a nearly irresistible manner.

In my opinion, the antidote to this forced growth is the introduction of systems and policies that will cooperatively direct more of the credit union systems' assets toward serving all credit union members and potential members including, with special emphasis, low income people.

Another complication in dealing with this problem is the fact that there is no one size fits all solution. Some of the largest credit unions do keep to the traditional philosophy and values of the original credit union movement. They make special efforts to reach out to low income people and to support small credit unions. Some of the managers of these large credit unions have expressed deep concern about the direction of the credit union movement. Unfortunately, the existing structure of the credit union system is so intimidating that most knowledgeable credit union people are afraid to speak out publicly.

I remain hopeful that it is still practically possible today to redirect the concentration of credit union assets from the current growth frenzy into areas or programs that could be of great benefit to low-income Americans. Surely, that is an effort work making.

Whatever actions might be taken to refocus the current credit union system on its traditional core values, I am absolutely certain of one reality that I hope I can adequately convey to this committee and to the Congress. That reality is that any effective effort to get credit unions as a whole to do a better job serving lower income households will *not* come from within the credit union power structure as it exists today. If this Congress doesn't demand it, it won't happen.

One place to begin might be to find ways to make credit union structures and operations more transparent. A survey such as I tried to send out in 1999 and as the GAO suggested in 2003 might be helpful. Thus far, the current structure's leadership has successfully resisted transparency. Beyond resisting objective measurements, they even succeeded in exempting their activities from the very reasonable disclosures made by other not for profit 501(c) groups as required by IRS form 990.

I am not here to advocate taxing credit unions. This committee and this Congress in its wisdom can certainly devise methods and criteria that will provide the American taxpayer with some assurance that the great benefit and advantage the tax exemption gives credit unions is not being abused. Hopefully, as a first step, a much greater degree of transparency will help root out, through exposure, some of the excessive profit motives that have been creeping into and seriously harming the system. At the least, it might give us a clearer picture of who the "free riders" are.

Mr. Chairman and members of the committee, I thank you for your attention and I will be pleased to address any questions you may have.

Chairman THOMAS. Thank you very much. Dr. Karels?

STATEMENT OF GORDON V. KARELS, PH.D., ASSOCIATE DEAN, COLLEGE OF BUSINESS ADMINISTRATION, UNIVERSITY OF NEBRASKA-LINCOLN

Dr. KARELS. Thank you, Chairman Thomas, Ranking Minority Member Rangel, and distinguished Committee Members. I want to express my appreciation for the invitation to testify before your Committee today. I just want to reiterate the main points of my submitted testimony: First, the rationale for credit unions' Federal income tax-exemption is not entirely transparent to me, and may no longer hold; Second, the credit union common bond requirement has evolved markedly since the granting of the tax-exemption, and no longer constrains credit union opportunities and incentives as it had in the past; Finally, the ultimate beneficiaries of the credit union tax-exemption are very difficult to determine. To me, the rationale for exempting credit unions from federal income tax is probably best understood by examining the reasons Congress eliminated the same exemption for mutual savings and loans and mutual savings banks in the Revenue Act 1951. According to the U.S.

Treasury 2001 study, the reason for the loss of the tax-exemption was the evolution of these associations as commercial bank competitors. Mutual thrifts operated in a manner similar to banks, and the exemption gave them a competitive advantage over taxable commercial banks and life insurance companies.

That same study also indicated that the original exemption in 1937 was based upon their mutual nature; being operated by and for their members. That was also consistent with the original 1917 administrative exemption for state credit unions that were said to closely resemble the cooperative banks and similar institutions Congress had earlier exempted. Credit unions evidently had preserved their mutuality in a fashion such that members were not just customers in other depository institutions. Clearly, credit unions competed with commercial banks, thrifts, and savings banks in the personal lending market. They also offered share accounts that served as deposits. But their uniqueness among depository institutions is quite apparent; and to me, that is the affinity among their members with a common bond. The common bond requirements subject credit unions managers to restrictions not found in other depository institutions. Loan opportunities are limited in the field of memberships, so that managers are constrained in their ability to grow the institution, and they may not rapidly change the riskiness of their loan portfolio.

In the case of credit unions with occupational common bonds, long the most dominant type, it also produces company sponsors who have an interest in monitoring the operations of the credit union and help promote safety and soundness. It is widely accepted that the mutual organizational form produces organizations that are not as risky as stock-based companies. This has been demonstrated at both banks and insurance companies. Some research that we did in looking at the adoption of federal deposit insurance by credit unions in the seventies found no evidence that the adoption of deposit insurance led to increased risk-taking in the credit industry. I think this was somewhat of a surprise in the academic community. We find that the common bond requirement helped to limit the risk-taking behavior of managers. In addition, loan size limitations help to constrain loan losses. While these limitations were relaxed and new types of loan and share accounts were allowed after 1977, they influenced the overall composition of the balance sheets for some time.

It is widely accepted that the NCUA's support for multiple employee groups grew out of concern about concentration risk. The recession of the 'eighties caused many industrial firms to close or relocate, and associated credit unions to fail. We did some research there, and found that the addition of select employee credit union groups allowed credit unions to dissipate some of this concentration risk; but at the same time, it reduced the informational advantage they had with the close common bond. In many ways, it seems that credit unions have evolved in a fashion similar to that of savings and loans 50 years earlier. Credit unions now have many powers that allow them to compete directly with other depository institutions in many lines of business. Furthermore, the common bond has become diluted. The tax-exemption gives credit unions a competitive advantage over depository institutions, and this advantage can manifest itself in various ways.

One might expect that credit unions would, because of their not-for-profit status, have a lower overall profitability than banks. As mutual organizations, the managerial priorities would seemingly favor competitive loans and deposit rates over profit levels. The emphasis on member services would also tend to drive up operating expenses and reduce profitability. Ultimately, the tax-exemption provides an avenue for credit unions to have a competitive advantage in loan and deposit rates that are still providing expanded levels of service and reasonable capital accumulation financed out of profits. Historically, we don't find that they necessarily have lower overall profitability. There is also mixed evidence as to whether they actually have lower net interest margins than other mutual organizations. In addition, there is mixed evidence as to whether credit unions are less efficient than other mutual types of organizations. In summary, all of these changes, I believe, parallel the developments that led to the taxing of mutual thrifts and savings banks. Deposit insurance has removed the issue of excessive burden of share accounts. It is not clear that credit union members have been the direct beneficiaries of the tax-exemption. At the same time, there is only limited evidence of expense preference behavior. Overall, it does not appear that a repeal of the exemption would be particularly detrimental to members, but would more likely affect the ability of credit unions to grow at the rates they have had in the past. Thank you.

[The prepared statement of Dr. Karels follows:]

Statement of Gordon V. Karels, Ph.D., Associate Dean, College of Business Administration, University of Nebraska-Lincoln, Lincoln, Nebraska

The views presented in this statement represent those of the author alone. The author is Associate Dean and Professor of Finance in the College of Business Administration at the University of Nebraska-Lincoln and holds the Nebraska Bankers Association College Professor of Banking Professorship. The Professorship was created in 1992 with a gift from the Nebraska Bankers Association to the University of Nebraska Foundation. College Professorship appointments are recommended to the University Chancellor by the Dean of the College upon review by a College Faculty Chaired Professorship Committee. The Nebraska Bankers Association sponsors endowed professorships at two of the University of Nebraska campuses. It does not participate in the selection of professorship recipients.

This statement addresses only the issue of the federal income tax exemption for credit unions and has three central points:

I. The rationale for credit unions' federal income tax exemption is not entirely transparent and may no longer hold.

II. The credit union common bond requirement has evolved markedly since the granting of the tax exemption and no longer constrains credit union opportunities and incentives as it had in the past.

III. The ultimate beneficiaries of the credit union federal income tax exemption are difficult to determine.

I. Historical Development of the Tax Exemption

There appears to be no disagreement as to the origins of mutual savings and credit associations or their purpose. Financial cooperatives such as mutual insurance companies and building associations emerged in the latter part of the 17th and early 18th century. The first credit associations were founded in Germany by business persons in need of financial services that were not provided by the existing commercial banking sector. These early organizations led to the development of three types of mutual depository institutions in the U.S.—credit unions, savings and loan associations and mutual savings banks—that have both complemented and competed with commercial banks.

U.S. Treasury (1997) outlines five characteristics that distinguish credit unions from other depository institutions.

1. Credit Unions are member-owned and member-directed cooperatives with each member having one vote. Technically credit union member deposits are the capital base of the organization. However these accounts also serve the traditional banking roles of checking and savings deposits so that over time, retained earnings serve the regulatory capital function.
2. Credit Unions rely on unpaid volunteers directors elected by and from their members.
3. Credit Unions are not for profit and return surplus earnings to members in various forms including higher returns on deposits (shares), lower costs of borrowing, greater financial services and retained earning for growth and regulatory capital needs.
4. Credit Unions have a public purpose. The Federal Credit Union Act of 1934 declares that credit unions are established for "promoting thrift among [their] members and creating a source of credit for provident or productive purposes."
5. Credit Unions have limitations on membership based on some affinity among members ("common bond").

All U.S. credit unions were originally state-chartered with federal chartering originating in 1934. State-chartered credit unions were not initially exempt from state or federal income taxes. An administrative ruling exempted state-chartered credit unions from federal income taxes in 1917. Federally-chartered credit unions were exempted from both state and federal income taxes in 1937.

The rationale for exempting credit unions from federal income taxes is probably best understood by examining the reasons Congress eliminated the same exemption for mutual saving and loan associations and mutual savings banks in the Revenue Act of 1951. U.S. Treasury (2001) cites the Senate Report of that Act as indicating the reason for the loss in the tax exemption was the evolution of these associations as commercial bank competitors. Mutual thrifts operated in a manner similar to banks and the exemption gave them a competitive advantage over taxable commercial banks and life insurance companies.

The 2001 Treasury study also suggest the original legislative exemption provided to federal credit unions in 1937 was based upon their mutual nature i.e., being operated by and for their members. In addition, taxing credit unions on their shares would be excessive because share accounts also function as deposits. This was consistent with the 1917 administrative exemption for state credit unions where they were said to closely resemble the cooperative banks and similar institutions that Congress had earlier exempted.

Credit unions evidently had preserved their mutuality in a fashion such that members were not just customers as in other depository institutions (including mutual thrifts). Clearly, credit unions competed with commercial banks, thrifts and savings banks in the personal lending markets. They also offered share accounts that served the deposit function. Their uniqueness among depository institutions was quite apparent: an affinity among members ("common bond"). This affinity appears to be the significant characteristic that explains the maintenance of the tax exemption.

II. The Role of the Common Bond

Credit union membership was historically limited to individuals sharing a common bond of occupation, association or geographical area. The common bond requirement subjects credit union managers to restrictions not found in other depository institutions. Loan opportunities are limited to the field of membership so managers are constrained in their ability to grow the institution or rapidly change the riskiness of the loan portfolio. In the case of credit unions with occupational common bonds—long the most dominant type—it also produces company sponsors who have an interest in monitoring the operations of the credit union and help promote safety and soundness.

It is widely held that cooperative and mutually organized firms are less risky than their stock-owned counterparts. For example, empirical evidence offered by Esty (1997) finds that stock-owned thrifts had both riskier portfolios and higher failure rates than mutuals. Lee, Mayers, and Smith (1997) find that risk in the asset portfolios of stock-owned property-liability insurers increased markedly relative to their mutually owned counterparts following enactment of state guaranty fund laws. This is not to say, however, that the mutual form of ownership guarantees limited risk-taking behavior. The large number of failures of mutual savings and loan associations in the 1980's speaks to this point. Indeed, a study by Esty (1993) of 1,737 mutual thrifts operating in 1982, found that over 28% failed (or had tangible net worth ratios less than 2%) by 1988.

Federal deposit insurance for credit unions was not instituted until 1971 and was not required of many state-chartered credit unions until the mid 1970's. A study by Karels and McClatchy (1999) found no evidence that the adoption of deposit insurance led to increased risk-taking in the credit union industry. They suggest that the common bond requirement helped to limit the risk-taking behavior of managers as deposit insurance was implemented by credit unions. In addition, loan size limitations and maturity limitations (5 years on unsecured loans and 10 years on secured ones) also helped to constraint loan losses. While these limitations were relaxed and new types of loans and share accounts were allowed after 1977, they influenced overall composition of balance sheet for some time after.

Beginning in 1982, the National Credit Union Administration (NCUA) reinterpreted the common bond requirement in a way to allow certain types of credit unions to add multiple groups referred to as "Select Employee Groups" or SEGSs. A successful court challenge to this interpretation eventually led to the passage of the Credit Union Membership Access Act of 1998, which explicitly allows for the addition of multiple groups to credit unions' fields-of-membership. By the time of the passage of that Act, over 4,000 state and federal credit unions had added SEGs to their memberships. By 1999, multiple common bond credit unions accounted for over 70 percent of total federal credit union assets.

It is widely accepted that the NCUA's support of multiple employee groups grew out concern about concentration risk. The recession of the 1980's caused thousand of industrial firms to close or relocate. Credit unions associated with such firms had limited memberships and subsequently experienced solvency problems. NCUA reported some 500 federal credit union liquidations or failures in 1981 alone. Frame, Karels and McClatchey (2002) examined the degree to which SEGs affected credit union risk. We found that a greater number of SEGs is associated with higher loan-to-share ratios, higher loan delinquency ratios and lower capital ratios. These results indicate that expanded membership does increase investment opportunities and hence reduces concentration risk but the informational advantage arising form the common bonds becomes diluted.

Since the passage of the Credit Union Membership Access Act, membership at credit unions with multiple bonds has actually declined. This is due in part to the rapid increase in community-charted credit unions. The terminology for the community field of membership allows for the greatest growth potential in the credit union industry and a significant number of federally-chartered credit unions are converting to community charters. Community and multiple common bond credit unions now account for over 80 percent of all assets in federally-chartered credit unions.

Of the 50 largest federal credit unions in 2003, only seven had a single associational or occupational bond. Six of the largest 50 were community chartered and the remaining 37 were multiple bond credit unions. While credit unions are still predominantly in the consumer lending area, business and real estate and business loans now account for nearly 30 percent of their loan portfolios (and the larger credit unions have relatively higher percentages of real estate and business loans compared to smaller credit unions). Twenty years ago, real estate and business lending accounted for only about 5 percent of credit union loans.

In many ways is seems that credit unions have evolved in a fashion similar to that of the saving and loan associations some 50 years earlier. Credit unions now have powers that allow them to compete directly with other depository institutions in many lines of business. Furthermore, the common bond has become diluted. The tax exemption gives credit union a competitive advantage over other depository institutions and this advantage can manifest itself in various ways. III. Who Benefits from the Tax Exemption?

Credit union's tax exemption would be expected to manifest itself in one or more of the following ways:

1. Higher deposit rates for members.
2. Lower loan rates for members.
3. Expanded services and products for members.
4. Higher capital ratios fund future growth or enhance safety and soundness.
5. Consumption perks for employees.

One might expect that credit unions would, because of their not-for-profit status, have lower overall profitability than banks. As mutual organizations, the managerial priority would seemingly favor competitive deposit and loan rates over profit levels. The emphasis on member services would also tend to drive up operating expenses and hence reduce profitability. Ultimately, the tax exemption provides an avenue for credit unions to have a competitive advantage in loan and deposit rates while still providing expanded service levels and reasonable capital accumulation levels that are financed out of profits.

Historically we do not observe credit unions having lower overall profitability than banks and thrifts. This may reflect the underlying risk of the loan portfolio position rather than managerial motives. Hinson and Juras (2002) examined this issue by comparing the spread between loan and deposit returns for credit unions and mutual savings and loans. Mutual thrifts were chosen as the comparison organization to control for the impact of ownership form on the profit motive of managers. They found that credit unions do not, on average, have lower net interest margins than mutual thrifts after adjusting for differences in the composition the loan portfolio and assets. They interpret this finding as evidence that credit unions are not passing along a significant portion of their tax exemption to members and may instead be using it to cover higher operating expenses.

Using the exemption to provide for managerial perks or to subsidize operating inefficiencies would misallocate the exemption benefits away from credit union members. Frame, Karels and McClatchey (2003) examine this question by estimating and comparing the cost functions of credit unions and mutual thrifts. We found mixed evidence in this regard. Credit unions with a residential common bond do have higher cost than mutual thrifts of similar size but single common bond occupational and associational credit unions are more cost efficient. There were no significant cost differences between multiple common bond credit unions and mutual thrifts

The profitability of credit unions has played an important role in accumulating regulatory capital. Both banks and credit unions have increased their capital by roughly the same proportion in the last 20 years. Credit unions did this in the first half of the period where profitability was relatively higher than banks and banks have done it in the second half of the period where they have been relatively more profitable than credit unions. In addition, growth in credit unions through common bond expansion or conversion to community charters has been more extensive in the last half of this period and this was accompanied by very limited increases in capital adequacy. Banks and credit unions appear to have converged to similar capital positions that are much stronger than in the past with asset portfolios and product lines that are much more similar.

Conclusion

Credit unions have matured and evolved greatly since the passage of the 1951 Revenue Act. Credit Unions are now modern depository institutions that offer a broad array of products to, in many instances, a very diverse customer base. Customer shares accounts have the added feature of deposit insurance which limits potential customer losses to near zero. Expanded lending powers allow credit unions to compete for residential mortgages longer-term, unsecured personal loans and business loans. Traditional, single-common bond associational and occupational credit unions now account for less than 50 percent of federally-chartered credit unions and for less than 20 percent of credit union assets. Credit union capital adequacy is very similar to that of commercial banks.

All of these changes parallel the developments that led to the taxing of mutual thrifts and savings banks. Deposit insurance has largely removed the issue of the excessive burden of share accounts cited in the 1937 exemption. It is not clear that credit union members have been the direct beneficiaries of the tax exemption. At the same time there is only limited evidence of expense preference behavior on the part of credit unions. Overall it does not appear that a repeal of the exemption would not be particularly detrimental to members but would more likely affect the ability of credit unions to grow at the rates they have in the past.

The “public purpose” characteristic is often cited as justification for the favorable tax and regulatory environment of credit unions. Extending financial services to individuals of small or modest means was embedded in the original common bond concept for credit unions. Credit unions have been very effective in providing services to its members but it is also apparent that banks, thrifts and other financial institutions also serve people of very modest means. If fact, one could argue that CRA reporting requirements provide better documentation of this public purpose for banks than credit unions.

There is obvious concern that the removal of the tax exemption will ultimately hurt individuals of modest means the most. While the evidence does not seem to point to that, perhaps other tax policies that provide direct benefits to these individuals instead of potential indirect benefits through a financial intermediary should be considered. Alternatively, providing for a class of loans to individuals of modest means that has an interest income exemption for all financial institutions (such as municipal bonds) might result in competition that more directly benefits individuals.

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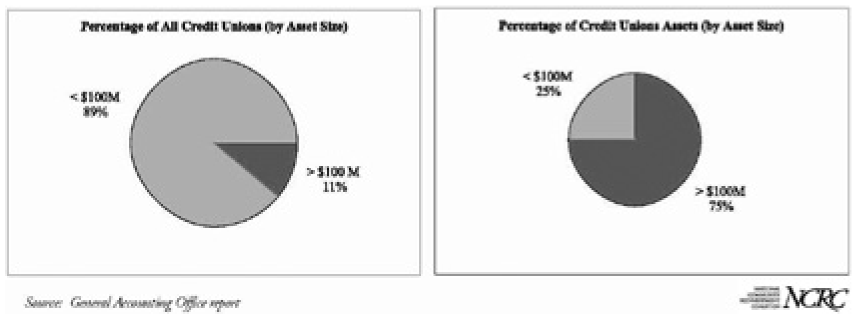
Chairman THOMAS. Thank you very much, Dr. Karels. Mr. Taylor.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good afternoon, Chairman Thomas and Ranking Member Rangel. The National Community Reinvestment Coalition is honored to be here today and to speak for our 600 community organizations across the country that comprise our membership. We are essentially a trade association of economic justice organizations working to increase access to credit and capital for minority and working-class families. The fundamental purpose and basis of establishing credit unions is the same as for the Community Reinvestment Act. The establishment of credit unions and the passage of CRA were motivated by concerns that lending institutions were not serving low- and moderate-income borrowers. When banks do not meet their CRA obligations, they face ramifications, including failing their CRA exams and possible denials of mergers and branching applications. When credit unions do not serve low- and moderate-income borrowers and communities, the penalties are non-existent. Unfortunately, NCRC's research indicates that large credit unions are not adhering to the mandate of the Federal Credit Union Act 1934 to "make credit available to people of small means."

Recently, NCRC conducted a comprehensive study, entitled "Credit Unions: True to Their Mission," which I believe we have supplied to the Committee. This study compared the performance of banks and credit unions serving minority communities and women and low-income borrowers in home loans. Despite credit unions' origins as institutions devoted to people of modest means, NCRC's study finds that banks make a higher portion of their home loans, with fewer loan denials, than credit unions, to traditionally under-served populations. The NCRC's study adds powerful evidence to the numerous studies over the years that have detailed credit unions' lackluster service to people of modest means. I am not including all credit unions because, obviously, some of them do an extremely good job. But I am talking about the majority of these credit unions, the large credit unions that constitute—I think we have a chart somewhere; it is not up—but that constitute the—could someone run over and put that chart up on the percentage of ownership?

[The information follows:]



If you look in terms of the percentage of assets that are controlled by a small number of credit unions, that is the group we are really focusing on and their lack of commitment toward underserved populations. A Federal Reserve survey revealed recently—and there was an earlier question from the panel about what income was being served—that 36 percent of the households that use credit unions had low and moderate incomes; in contrast to 42 percent of the households that primarily use banks. The GAO released a report finding that banks provided 34 percent of their mortgage loans to low- and moderate-income borrowers; while credit unions issued just 27 percent of the loans to borrowers in 2001. The NCRC's study finds over a three-year period, from 2001 to 2003, when all types of home lending are considered, banks out-perform credit unions in 36 states; or 72 percent of the states. When just home purchase lending is analyzed by itself, credit union performance drops off even more. Banks out-perform credit unions in 40 of the 50 states; or 80 percent of the time.

In home purchase lending, the difference in bank and credit union performance was usually substantial. For example, in 2003, banks made 14.1 percent of their loans to minority neighborhoods; whereas credit unions issued just 7.9 percent. In 2003, banks made 21 percent of their home purchase loans to women; credit unions issued 18.7 percent of their loans to women across the country. In 2003, banks made 9 percent of their home purchase loans to Hispanics; credit unions, 4.8 percent to Hispanics across the country. In your home State of California, Mr. Chairman, banks made 18.3 percent of their home purchase loans to Hispanics; while credit unions issued 12.4 percent to borrowers in 2003. In your home State of New York, Ranking Member Rangel, banks made 16.6 percent of their home purchase loans in minority neighborhoods; while credit unions issued just 5.1 percent in these tracts during 2003.

Finally, banks made 5.6 percent of their home purchase loans to African-Americans; whereas credit unions issued just 2.8 percent of their purchase loans to African-Americans in 2003. In preparing for this testimony, NCRC conducted analysis of the most recent data, the 2004 HMDA data, Home Mortgage Disclosure Act data. This analysis shows once again that credit unions trail banks in making loans to minorities, to women, and to low- and moderate-income borrowers and communities. The chart in our testimony shows that banks exceeded credit union performance on all nine CRA and fair lending indicators. In addition, the largest credit unions—Navy Federal Credit Union, who you just heard from, and Golden 1 in California—also performed poorly. Navy Federal lags all credit unions on five of the nine indicators of performance, and Navy Federal lags all banks and thrifts on eight of the nine indicators of performance.

I think the question posed by the gentleman from North Dakota is a very accurate one, about the presence of so much predatory lending business butting up to and surrounding military bases. It begs the question: if the Navy Federal Credit Union is doing such a great job and serving people in the Service, why are they surrounded by predatory lending, payday lenders, and other kinds of sharks that are literally across the street from the bases where the men and women of Service, as the President of the Navy Credit Union pointed out, are being taken advantage of? Let me close by saying large credit unions and their trade associations should not be comfortable in arguing to Members of Congress that, while credit unions lag banks, credit unions are getting better. Their tax benefits and other privileges dictate that they should be better. More importantly, you are right, Mr. Chairman. Why would Congress be satisfied with credit unions lagging banks, considering the valuable benefits bestowed on these institutions by the American taxpayer?

In my home State of Massachusetts, we actually have CRA for credit unions. If you look at our study and you look at the performance of state-run, state-mandated credit unions compared to banks, guess what? With the presence of CRA, they perform just the same as banks in terms of serving low-income, minorities, and women. The NCRC recognizes that a significant segment of the credit union industry remains devoted to serving people of modest means. But don't be misled that Ms. May constitutes anything near what the majority of the credit unions are made up of—the majority of number of credit unions, certainly; but in terms of who controls the assets, it is a very, very different picture. By the way, I have got to say, just as an aside, I really love all this conversation from the majority, talking about the need to increase access to credit and capital for under-served people, for poor people and people of modest means. I hope that carries over in a lot of other ways. Because I think you are absolutely right on in that perspective, because it continues to be a problem. Predatory lending is growing in this country.

Taking the time to really look at institutions that get public benefit, whether it is from depositors' insurance; applied guarantees like the GSC's, the "too big to fail"; or whether it is credit unions having tax-exemption—which by the way, for the record, we continue to support the tax-exemption for these credit unions; but we think the most wise avenue for the credit unions, for CUMAA and the large credit unions to take, and the wisdom that they could show the rest of the industry, would be to endorse the CRA-like applications so there is a level playingfield between those community banks and other banks, and that they have to serve under-served populations, which is what they have not been doing. Thank you, Mr. Chairman, for your indulgence.

[The prepared statement of Mr. Taylor follows:]

Statement of John Taylor, President and Chief Executive Officer, National Community Reinvestment Coalition

Introduction

Good Afternoon, Chairman Thomas and Ranking Minority Member Rangel. NCRC is honored to be here today as the voice for over 600 community organizations from across the country that comprises the National Community Reinvestment Coalition. NCRC is the nation's economic justice trade association dedicated to increasing access to credit and capital for minority and working class families. Our member organizations represent communities from your congressional districts. These organizations include the California Reinvestment Coalition, the Greenlining Institute, Inner City Press/Community on the Move, and Rural Opportunities, Inc. We appreciate you convening today's hearing on an issue that our members have been addressing for the last several years.

When NCRC first started analyzing credit union performance, we were hoping that we would find that the credit union industry, by and large, was adhering to mandate of the Federal Credit Union Act of 1934 to "make credit more available to people of small means." Our research indicates that a very important segment of the industry, community development credit unions, is devoted to serving the working poor and modest income customers. As a disclaimer, some of the leading community development credit unions in the country are NCRC members, including the Bethex Federal Credit Union in New York City, the Enterprise Corporation of the Delta based in the Gulf region afflicted by Hurricane Katrina, and the North Side Community Federal Credit Union in Chicago. In addition to the community development credit unions, we do not doubt that a number of traditional credit unions have also stayed true to the 1934 law. However, we have found repeatedly that large credit unions have strayed from their mission and the letter and spirit of the Federal Credit Union Act.

The fundamental purpose and basis of establishing credit unions is the same as for the Community Reinvestment Act (CRA). The establishment of credit unions and the passage of CRA were motivated by concerns that lending institutions were not serving low- and moderate-income borrowers. Congress therefore passed legislation creating credit unions as lending institutions focused on low- and moderate-income communities and borrowers, and then Congress imposed upon banks a continuing and affirmative obligation to serve low- and moderate-income borrowers. When banks do not meet their CRA obligations, they face ramifications including failing their CRA exams and/or denials of merger and branching applications. When credit unions do not serve low- and moderate-income borrowers and communities, the penalties appear to be non-existent.

NCRC's Study Agrees with a Substantial Body of Research—Large Credit Unions Need to Do a Better Job In reaching Minorities, Women, and Low-Income Borrowers

Recently, the National Community Reinvestment Coalition (NCRC) conducted a comprehensive study, entitled "Credit Unions: True to their Mission." This study compared the performance of banks and credit unions in serving minorities, women, and low- and moderate-income borrowers with home loans. Despite credit unions' origins as institutions devoted to people of modest means, NCRC's study finds that banks make a higher portion of their home loans with fewer loan denials than credit unions to traditionally underserved populations. NCRC's study is the first that we know of that has compared credit union and bank performance in home lending over three years across the country as a whole and in each state. A copy of the report can be found on our website at http://www.ncrc.org/policy/states/credit—union—report.php.

In 1934, the Federal Credit Union Act (FCUA) established the federal supervision of credit unions as alternatives to banks. The necessity for such an alternative arose because the financial needs of low- and moderate-income people were not being met by traditional lenders Spurred by the 1934 legislation, credit unions increased their presence around the country as lending institutions controlled and owned by people of modest means. Based on the assumption that credit unions are serving the needs of low- and moderate-income members, credit unions are afforded certain benefits, such as federal tax exemptions, to help them fulfill their mission.

In the year 2005, after 70 years of federal supervision of credit unions, most people would be surprised to learn that banks are doing a better job of serving low- and moderate-income people than credit unions. This comes in the wake of the 1998 Credit Union Membership Access Act, which provided for significant expansions of credit union membership. While this law empowered credit unions by reversing Supreme Court restrictions on credit union membership, it has not resulted in credit unions markedly improving their performance in lending to traditionally underserved communities.

NCRC's study adds powerful evidence to the numerous studies over the years that have detailed credit unions' lackluster service to people of modest means. The Federal Reserve's 2001 Survey of Consumer Finances revealed that only 36 percent of the households that primarily used credit unions had low- and moderate-incomes in contrast to 42 percent of the households that primarily used banks. In 2003, the Government Accountability Office (GAO) released a report finding that banks provided 34 percent of their mortgage loans to low- and moderate-income borrowers while credit unions issued just 27 percent of their loans to these borrowers in 2001. NCRC's previous analyses of Home Mortgage Disclosure Act (HMDA) data also showed that credit unions trailed banks in the percent of their loans to low- and moderate-income borrowers in 1999 and 2000.

In the first study of its kind, NCRC's three year analysis concludes that banks consistently exceed credit unions' performance in lending to women, minorities, and low- and moderate-income borrowers and communities. NCRC scrutinized lenders' performance on 14 fair lending measures including the percent of loans to different groups of borrowers and the differences in denial rates to minorities versus whites and low- and moderate-income borrowers versus middle- and upper-income borrowers. Banks are compared to credit unions because federal Community Reinvestment Act (CRA) requirements to serve low- and moderate-income communities apply to banks but not credit unions.

When considering performance in home purchase lending by itself, or when considering home purchase, refinance and home improvement lending combined, credit unions consistently lagged banks in service to minorities, low- and moderate-income (LMI) borrowers, women, and LMI and minority neighborhoods. Over a three year period from 2001 through 2003, when all three loan types are taken together, banks outperformed credit unions in 36 states or 72 percent of the states. When home purchase lending is analyzed by itself, credit unions' performance drops off even more—banks outperform credit unions in 40 states or 80 percent of the time.

In home purchase lending, the difference in bank and credit union performance was usually substantial, even in 2003 when credit unions were performing better than they were in previous years. *For example, in 2003, banks made 14.1% of their loans to minority census tracts whereas credit unions issued just 7.9%.* Likewise, banks made 20.8 percent of their loans in minority and/or low- and moderate-income

(LMI) tracts whereas credit unions issued just 15.3 percent of their home purchase loans in these tracts across the United States in 2003.

Other examples of large differences in performance include:

In 2003, banks made 21.8% of their home purchase loans to women; credit unions issued 18.7% of their loans to women across the country.

In 2003, banks made 9% of their home purchase loans to Hispanics; credit unions, 4.8% to Hispanics across the country.

In Florida, banks made 17.1 percent of their home purchase loans to Hispanics; credit unions issued 9.9 percent of their loans to Hispanics during 2003. Banks made 25.4 percent of their home purchase loans to women; credit unions offered 19.4 percent of their loans to women in Florida during 2003.

In Texas, banks made 25.1% of their home purchase loans to LMI borrowers; credit unions issued 20.2% of their loans to LMI borrowers in 2003. Banks made 11.8% of their purchase loans to LMI minorities while credit unions issued 6.2% of their loans to these borrowers in Texas during 2003.

In California, banks made 18.3% of their home purchase loans to Hispanics while credit unions issued 12.4% to these borrowers during 2003. Likewise, banks made 35.1% of their purchase loans to residents of minority census tracts; credit unions made just 25.6% of their loans to these census tracts.

In New York, banks made 16.6% of their home purchase loans in minority census tracts while credit unions issued just 5.1% in these tracts during 2003. Banks made 23.5% of their purchase loans to women while credit unions made just 18.7% of their loans to women in 2003 in New York. Finally, banks made 5.6% of their home purchase loans to African-Americans whereas credit unions issued just 2.8 percent of their purchase loans to African-Americans during 2003. This disparity is even larger than the national difference (banks made 5.4% and credit unions made 4.4% of their loans to African-Americans during 2003).

Home purchase lending represents the means by which most Americans build wealth; home purchase lending is perhaps the most difficult type of home lending since more families buying homes for the first time will be less wealthy or have fewer assets than families refinancing their mortgage loans. It is distressing that mainstream credit unions lag banks by an even greater extent in home purchase lending than other types of home lending since home purchase lending represents the gateway towards the American Dream of homeownership, wealth building, and providing for one's family.

The results in NCRC's analysis are driven by large credit unions as they make the most loans in the credit union industry. For the year 2003, the top 25 credit unions (in terms of highest number of loans) had a median asset size of $2.3 billion and a median membership base of 250,094. The top 25 credit unions made 220,867 loans overall and issued 28 percent of the single family loans (home purchase, refinance, and home improvement) made by credit unions across the country in 2003. The median loan amount was 5,637 loans for top 25 credit unions.

Here are some loan totals and membership sizes of large credit unions:

Navy Federal—68,567 loans and 2.5 million members

Golden 1 Credit Union—18,774 loans and 625,559 members

Boeing Employees Credit Union—9,673 loans and 401,783 members

In preparing for this testimony, NCRC conducted analysis with the new 2004 HMDA data for single family lending (home purchase, refinance, and home improvement lending combined). This analysis shows once again that credit unions trail banks in making home loans to minorities, women, and low- and moderate-income borrowers and communities. The chart below shows that banks exceeded credit union performance on all nine CRA and fair lending indicators. In addition, the chart reveals that the largest credit unions, Navy Federal and Golden 1, also perform poorly. Navy Federal lags all credit unions on 5 of the nine indicators of performance and Navy Federal lags all banks and thrifts on eight of the nine indicators of performance. Golden One performs better than Navy Federal but still lags banks on 6 of the 9 indicators.

Credit Union/Bank Comparison 2004 Single Family Lending Trends									
Portfolio Share Indicators	Navy FCU	Golden 1	Credit Unions	Banks/Thrifts	NFCU - CU	NFCU - B/T	G1 - CU	G1 - B/T	CU - B/T
% to Blacks	10.41%	5.32%	5.38%	4.26%	5.1%	4.2%	0.3%	-0.7%	-0.96%
% to Hispanics	3.97%	2.77%	4.36%	5.09%	1.0%	5.8%	0.2%	2.9%	4.1%
% to LMI Borrowers	11.87%	14.39%	25.37%	36.28%	-14.0%	-14.6%	-11.0%	-11.4%	-0.41%
% to Women	11.82%	13.46%	18.15%	21.39%	-6.4%	-9.6%	-1.7%	-4.3%	-3.20%
% to Minority Tracts	15.27%	25.32%	11.77%	16.30%	3.7%	-1.1%	12.0%	7.5%	4.77%
% to LMI Tracts	9.77%	14.52%	12.07%	13.70%	-2.3%	-4.0%	2.5%	0.8%	-1.6%
Denial Disparity Ratios									
Blacks to Whites	2.9	1.23	2.32	1.04	0.59	1.86	-.27	-0.19	0.09
Hispanics to Whites	2.02	2.11	1.17	1.92	-0.13	0.31	-4.06	0.36	0.65
Minority to White Tracts	1.74	1.70	2.07	1.47	-0.37	0.28	-4.21	0.23	0.35

Advantage					
Portfolio Share Indicators	NFCU - CU	NFCU - B/T	G1 - CU	G1 - B/T	CU - B/T
% to Blacks	NFCU	NFCU	G1	B/T	B/T
% to Hispanics	CU	B/T	G1	B/T	B/T
% to LMI Borrowers	CU	B/T	CU	B/T	B/T
% to Women	CU	B/T	CU	B/T	B/T
% to Minority Tracts	NFCU	B/T	G1	G1	B/T
% to LMI Tracts	CU	B/T	G1	G1	B/T
Denial Disparity Ratios					
Blacks to Whites	CU	B/T	G1	G1	B/T
Hispanics to Whites	NFCU	B/T	G1	B/T	B/T
Minority to White Tracts	NFCU	B/T	G1	B/T	B/T
Totals					
	CU: 5 NFCU: 4	B/T: 8 NFCU: 1	G1: 7 CU: 2	B/T: 6 G1: 3	B/T: 9 CU: 0

NCRC's study acknowledges that credit union performance improved over each year of the analysis. However, banks were still exceeding credit union fair lending performance in the great majority of states by 2003. This is indeed not good performance for institutions that were originally devoted to serving the credit needs of poor people. Large credit unions and their trade association should not be comfortable in arguing to members of Congress that while credit unions lag banks, credit unions are getting better. Their tax benefits and other privileges dictate that they should be better. More importantly, why would Congress be satisfied with credit unions lagging banks considering the very valuable benefits bestowed on these institutions by the American taxpayer. The mission established in the Federal Credit Union Act of 1934 requires credit unions to lead banks in lending to minorities, women, and low- and moderate-income borrowers, not lag behind banks. Moreover, the diverse and large membership bases of these large credit unions should provide plenty of opportunities to serve women, working class Americans, and people of color.

When considering lending on a national level, we find that bank fair lending performance exceeds credit union performance by even greater margins than when considering performance state by state. This finding is the result of banks consistently out-performing credit unions in the largest states while credit unions held the advantage in states that were predominantly rural and less heavily populated.

Just one state in our country, Massachusetts, has applied CRA to credit unions over a long period of time. Our study featured a perfect control experiment in that it compared the performance of state-charted credit unions in Massachusetts against federally-charted credit unions not subject to CRA. When considering home purchase, home improvement and refinance lending together, state-chartered credit unions outperform their federally-chartered counterparts in Massachusetts 69 percent of the time. While banks outperform all credit unions in Massachusetts 71 percent of the time in single family lending, banks and state-chartered credit unions perform almost the same—the bank advantage is reduced to only 55 percent.

NCRC recognizes that a significant segment of the credit union industry remains devoted to serving people of modest means. Community development credit unions (CDCUs), for example, are specifically dedicated towards communities left out of the financial mainstream. About 300 CDCU's have more than 860,000 members and assets of $3.1 billion. But the credit union industry is now large, totaling over 9,000 credit unions with assets of $629 billion. While a number of credit unions toil daily to reach poor people, it is clear that the industry as a whole has some catching up to do and also has the resources to do a much better job.

NCRC's findings strengthen the argument that credit unions overall are not meeting their intent of serving low- and moderate-income people. Based on our analysis of the impact of Massachusetts' Community Reinvestment Act (CRA) law and our findings that CRA regulated banks consistently outperform credit unions on fair lending measures, NCRC concludes that federal CRA must be expanded to large, mainstream credit unions. Research has long documented CRA's effectiveness in its application to banks. Likewise, CRA can be effectively applied to credit unions as is evidenced by the Massachusetts experience. Since the Federal Credit Union Act of 1934 and CRA have the same fundamental purpose—ensuring that low- and moderate-income borrowers and communities are served—doesn't make sense that CRA be applied to large, mainstream credit unions that need a legal and regulatory push to better serve people of "small means."

Credit Union Industry's Regulatory Relief Proposal Goes in the Wrong Direction

Finally, we are also concerned by the credit union's attempt to seek regulatory relief that demonstrates the industry's interest to abandon its public obligation to underserved areas and those with modest means. The credit union's regulatory relief proposals include efforts to expand their fields of membership, expand commercial lending, and to serve underserved communities with ATMs instead of full service branches. In June of 2004, CUNA testified before the Senate Banking Committee on Regulatory Relief, requesting that Credit Unions be allowed to serve underserved communities with ATMs. We have seen this request reappear this year as a regulatory relief proposal for consideration by the Senate. This request would repeal existing law and undermine the intent of both House Report 105–472 and Senate Report 105–193 language that explicitly stated that the term "facility" does not include an ATM.

House Report, 105–472, August 1998

"Any person or organization within an underserved local community, neighborhood, or rural district may be added to multiple common bond credit unions which establishes and maintains an office or facility in the underserved areas. The term 'facility' in the Act is meant to be defined in the same way that the National Credit Union Administration ('NCUA' or 'Board') has defined 'service facility,' that is, an automatic teller machine or similar device would not qualify."

Senate Report, 105–193, August 1998

"An additional exception exists for persons or organizations within a local community, neighborhood or rural district that is underserved by other depository institu-

tions. These persons or organizations may join an existing credit union provided that the credit union establishes a service facility in that area. The term 'facility' is meant as it is defined by the NCUA. An automatic teller machine or similar device does not qualify as a service facility."

Throughout HR 1151, the Federal Credit Union Act of 1998, Congress made clear and reaffirmed in its findings the public purpose of credit unions, "SEC. 2. (1) The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means." The request by credit unions to serve underserved communities only with ATMs is inconsistent and in conflict with the public purpose of credit unions to serve the credit needs of those individuals of modest means.

While our goal is not to limit the growth of credit unions, it is to ensure that credit unions maintain their focus on underserved areas. Instead, we see their proposal on Community Credit Union Membership as an attempt by the credit union industry to distort and inappropriately expand their fields of membership to areas which credit unions view as desirable and profitable, rather than to underserved areas, despite the original and reaffirmed mission to serve people of modest means.

This proposal would undermine Congress's enactment of the Credit Union Membership Access Act (CUMAA) HR 1151, and therefore, its affirmation that credit unions have a mandate to serve the underserved. Through CUMAA, Congress permitted a limited exception for multiple-bond credit unions to expand their fields of membership by adding underserved areas. Currently, adding underserved areas is one of the only means by which multiple bond credit unions can actively expand their fields of membership. In providing an exception for underserved areas, Congress reaffirmed the original mission of credit unions to serve those with modest means.

The credit union industry is also requesting to shift the focus of business lending from those persons of modest means to commercial lending that does not serve persons of modest means. Throughout Senate Report 105–193, the intent was clear, *"Title II reaffirms that insured credit unions have a continuing obligation to meet the financial services needs of persons of modest means, including low- and moderate-income individuals".* We believe that credit unions should improve upon its home purchase lending to persons of modest means and not on expanding its business lending to serve large commercial firms.

In general we are troubled by the attempts of the credit union industry to seek relief from public law and guidance that is fundamental to its public purpose and obligation. We are also concerned by this request because it demonstrates the credit union industry's interest to abandon its public obligation to undeserved areas and those with modest means. NCRC and our 600 member organizations have worked diligently to insure that the banking industry serve and provide branches to underserved communities through the CRA where they are held accountable. Should the credit unions be successful in obtaining their regulatory relief proposals they would enjoy expanded fields of membership and expanded commercial lending without any check and balances to insure that they are serving persons of modest means.

The next step in the evolution of credit unions in this country is applying CRA to mainstream credit unions, thereby requiring these credit unions to abide to an affirmative and continual obligation of meeting the credit needs of low- and moderate-income communities.

Chairman THOMAS. Thank you. Ms. Kennelly, before we ask for your testimony, I just want to indicate that every Member indeed, those who aren't here and the Members of Congress, offer our sincere condolences. You folks were right in the heart of what was an extremely difficult, tragic, natural disaster—perhaps exacerbated by some man-made assistance, but the devastation was there nevertheless. Our colleague, the gentleman from Louisiana, Mr. Jefferson, and my colleague, the gentleman from Louisiana, Mr. McCrery, have been focused on trying to make sure that, at a minimum, life is restored back to some semblance of normal as soon as possible. I am anxious to hear where you were, where you are, and what has been going on, from someone who obviously is at the forefront in listening to, hearing, and probably trying to meet people's needs who had no understanding of what their needs were going to be just a couple of months ago.

STATEMENT OF CONSTANCE KENNELLY, CHIEF EXECUTIVE OFFICER, TULANE-LOYOLA FEDERAL CREDIT UNION, NEW ORLEANS, LOUISIANA

Ms. KENNELLY. Exactly. Thank you very much. I must admit, I did evacuate. I did not stay. Chairman Thomas, Ranking Member Rangel, distinguished Members of the Committee on Ways and Means, I do want to express my profound gratitude for the opportunity to testify before you today, and to share with you my personal story and those of others regarding the ways in which credit unions assisted them and their families and untold thousands of other people in the aftermath of Hurricanes Katrina and Rita, in ways that I believe are unique. I also want to express my appreciation to my fellow Louisianians, Congressman Jefferson, who represents a significant number of my members, and Congressman McCrery, for their continuing efforts in the Committee to help our devastated state recover. I am, and have been since 1998, the Chief Executive Officer of the Tulane-Loyola Federal Credit Union, and I am also a member. Our membership includes the faculty, staff, and students from Tulane University, Tulane Hospital, and Loyola University, which I think spreads the gamut of income across the board.

We are small, with slightly less than $15 million in assets and 5,000 members. In addition, our credit union is unique, in that it has been designated as a low-income credit union, which will allow the credit union to receive grants to serve low-income members of the community, including those devastated by the hurricane. As you might imagine, Hurricane Katrina's impact on our membership and on the membership of credit unions throughout the greater New Orleans area has been catastrophic. More than 4,800 of our members were evacuated, and many were—and some still remain—temporarily located throughout the United States; some in remote areas, but with fairly heavy concentrations in Baton Rouge, Houston, Dallas, and Atlanta. To date, only about 30 percent have actually returned to the New Orleans area. It has been reported that the universities plan to reopen for the spring semester in January of 2006; however, it still remains unclear how many of our members will be able to return home by that time.

Of our 14 staff members, five lived in the areas of total devastation now well known to most of the Nation: the Lower Ninth Ward of New Orleans, New Orleans East, and Saint Bernard Parish. They may not be able to return. During the storm's aftermath, I had my personal cell phone number listed on the National Credit Union Administration's website, as well as on our own website, for member contact. The calls were answered from 7:00 a.m. until 11:30 p.m., and most of the information requested was related to being able to access their funds. I was able to direct them to the service center link on our website, or to provide them with the information directly if they did not have access to a PC. During the first few days, I responded personally to over 700 e-mails from members. For weeks, there were overlapping, non-stop phone calls. With rare exception, Members were able to access their funds conveniently from credit union service centers or outlets within the cooperative credit union network of people helping people. In only two instances were members located outside of a convenient radius—that is, greater than 25 miles from the nearest branch—and for those, funds were wired to them at no cost.

In so many instances, Louisianians were not just separated from their homes; they were also separated from family and from the means by which to live. Many were left not only homeless, but penniless as well. With phone lines and other means of communication compromised, ATM service was sporadic throughout the affected area. Even credit and debit card use was limited in many areas. Moreover, most people who evacuated—including myself—never envisioned the level of destruction wrought by Katrina, and were thinking that they would only be away from home for a couple of days; not weeks or even, as we have seen, months. Thankfully, credit union members have access to something unique in the financial services industry, and it is a cooperative, shared branching network. Because of this network, our members were able to walk into credit unions all over the country—in Texas, in California, in Georgia, and elsewhere in Louisiana—and access their funds, obtain emergency loans, initiate lines of credit, increase their credit card limits, and receive other critical financial services, with no questions asked, as though they were at their own home credit union. To my knowledge, there is no similar shared access system in the banking sector. Moreover, while we had certainly planned for emergencies, an event of this magnitude is unprecedented; and yet the shared branching network far exceeded the expectations, and ensured our members the financial access they needed.

We heard from members who had been separated from their family. There was one, a sister, who had been separated. Funds were transferred from their joint account. We were able to intervene and allow the apartment owners to actually waive the $175 fees. We had another instance with an incoming Tulane student who had joined the credit union literally 1 hour before they were told to evacuate with their family. They called. We had not processed the check, but we immediately made that $1,000 available to them. To sum it up again, I do want to thank you for your indulgence. I see that I have gone over by 27 seconds right now. I want to add that not only do we as credit unions not pay taxes; we don't pay our volunteers. We are run by credit unions. Although we are considered not-for-profit, we have to make a profit, because we have to maintain a level of capital above that of other financial institutions. So, we are not-for-profit; we meet capital expectations; and we do not pay our directors. Thank you very much, Chairman.

[The prepared statement of Ms. Kennelly follows:]

Statement of Constance Kennelly, Chief Executive Officer, Tulane-Loyola Federal Credit Union, New Orleans, Louisiana

Chairman Thomas, Ranking Member Rangel, distinguished members of the Committee on Ways and Means, I want to express my profound gratitude for the opportunity to testify before you today and to share my personal story and those of others regarding the ways in which credit unions assisted them and their families and untold thousands of other people in the aftermath of Hurricanes Katrina and Rita in ways that I believe are unique. I also want to express my appreciation to my fellow Louisianans, Congressman Jefferson, who represents a significant number of my members, and Congressman McCrery for their continuing efforts in the Committee to help our devastated state recover.

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During the first few days, I responded personally to over 700 emails from members. And for weeks there were overlapping, non-stop phone calls. With rare exception, members were able to access their funds conveniently from Service Centers or Outlets within the cooperative Credit Union network of people helping people. In only two instances were members located outside of a convenient radius, that is, greater than 25 miles from the nearest service center or branch, and for those, funds were wired to them at no charge.

In so many instances, Louisianans were not just separated from their homes; they were also separated from family and from the means to live. Many were left not only homeless, but penniless as well. With phone lines and other means of communication compromised, ATM service was sporadic throughout the affected area; even credit and debit card use was limited in many areas. Moreover, most people who evacuated never envisioned the level of destruction wrought by Hurricane Katrina and the subsequent deluge. Quite reasonably, given common experience, most of those who evacuated were prepared to be away from home, away from their livelihoods, for a few days. When they left, they had no idea—no reason to expect—they would need to be prepared to be gone for weeks or, as we have seen, months.

Thankfully, credit union members have access to something unique in the financial services industry—a cooperative shared branching network. Because of this network, our members were able to walk in to credit unions all over the country—in Texas, in California, in Georgia and elsewhere in Louisiana—and access their funds, obtain emergency loans, initiate lines-of-credit, increase credit card limits, and receive other critical financial services with no questions asked as though they were at their home credit union. To my knowledge, there is no similar shared access system in the banking sector. Moreover, while we had certainly planned for emergency situations, an event of this magnitude is unprecedented, and yet the shared branching network far exceeded expectations and ensured our members the financial access they needed in the days and weeks after their lives were turned upside down by Hurricane Katrina.

We heard from a member who had been separated from her sister and grandmother during the evacuations from the Superdome. The sister had transferred funds from the joint account by telephone teller unbeknownst to the member who wrote a check for rent in Houston. Ultimately, we assisted the member by having the apartment complex reverse the NSF charges imposed on her.

Another of our members called to re-order checks in order to be able to rent an apartment for his family. In the interim period, we wired funds for him at no charge. For other members, we expedited loans for displaced members, waived fees for stop payments and wires, and deferred loan payments until the end of November.

An incoming Tulane student, who had joined the credit union just an hour before being evacuated on the Saturday before Katrina, contacted us for a withdrawal. Knowing the circumstances, we credited his $1,000 deposit immediately even though the check had not been processed.

A credit union in the Lake Charles area promptly accommodated several of our members by providing withdrawals, even though they were not, at that time, a part of our shared branch network, and we, in turn, wired covering funds to them. During the first weeks after Katrina, one Service Center even agreed to accept and post payments from auto insurance companies totaling our members' automobiles, sight unseen.

These are just a few examples of the manner in which credit unions care for the needs of their members. I represent just one of many credit unions whose members were adversely affected by the recent hurricanes, and yet I sit before you today certain that my colleagues at those credit unions and their members could recount hundreds of similar acts of kindness and compassion too seldom found in the financial services sector. For us, and for our members, caring, and not profit, is the rule.

From a member's perspective, a credit union represents caring and thoughtful service, even during the most difficult of times. Members may be unaware of the size of their credit union, but they care deeply about the personal service, convenience and responsiveness. While Hurricane Katrina and its aftermath were extraordinary circumstances, thanks to the member-oriented approach of credit unions throughout the country, we were able to provide a lifeline to our members and fulfill our stated mission of taking care of our membership one member at a time.

Thank you again for the opportunity to testify.

Chairman THOMAS. Thank you, Ms. Kennelly. Does the gentleman from Louisiana, Mr. McCrery, wish to inquire?

Mr. MCCRERY. Mr. Chairman, I don't have any questions. I appreciate the testimony of the panel. We have had some thought-provoking testimony, I think, today from all three of our panels. I commend the Chairman for undertaking this responsibility of the Committee to review the tax-exempt status of institutions that have that grant from the Federal Government. Certainly, we ought to continue this with other institutions, as well. But I do think today's testimony has been enlightening in many respects, and gives us a good bit to look at and examine as we move forward with these hearings. So, I thank the Chairman for holding the hearing, and thank the panel for their testimony.

Chairman THOMAS. Thank the gentleman. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. I just want to join with you and Mr. McCrery and others. It has been an interesting hearing, and this last panel added some provocative thoughts. Thank you.

Chairman THOMAS. The gentleman from Texas, Mr. Brady?

Mr. BRADY. Mr. Chairman, one, I think this has been an excellent hearing. My only point would be I think regulation has a cost, and sometimes an unintended consequence. If we were a banking Committee, I would be taking a good, hard look at the whole regulatory structure on all our lenders in the community, to see and make sure, as I think that we have, I think, overburdened them in areas that they ought not be. I think we ought to provide a lot more flexibility than we do today. But with that, again, thank you for holding this hearing.

Chairman THOMAS. Thank the gentleman. The gentleman from Louisiana.

Mr. JEFFERSON. I thank you, Mr. Chairman. I don't have any questions, either. I do want to thank Ms. Kennelly for having come and for the testimony she offered, as well as the other witnesses, but particularly her; and for the work that she did to help relieve the suffering and to provide some point of contact for people who were displaced all over the country as a result of the horrific events of Hurricane Katrina, and Rita after that. I think what is really important here is that there may be some differences of opinion about the tax-exempt status, or about the lending practices, or whatever; but I think the importance of a hearing like this is that these things get aired, and that from each side there can be, we hope, some basis on which the private sector can find a way to come together itself and resolve some of these issues without the need for there to be any intervention by this Committee or by any Committee of Congress. Sometimes, just by having these matters explored as they are and having others hear the concerns, one here in front of the other, helps to bring resolution to the problem and helps to prod some of us to make changes where we hadn't really thought about the need to do that. So, I am hopeful that out of this will come some voluntary action on the part of those who may feel themselves on the edge of some concerns of others, and find a way to work things out before the Congress has to make any decision about stepping in on that. So, I want to thank the Chairman for bringing the parties together and for holding this hearing. I think it has been very beneficial.

Chairman THOMAS. Thank the gentleman. The gentlewoman from Pennsylvania.

Ms. HART. No questions.

Chairman THOMAS. The gentleman from California.

Mr. BECERRA. Thank you, Mr. Chairman. I, too, would like to thank the panel for its testimony. I have one question for Ms. Kennelly; but I would like, before I do ask the question, to say that I hope that what we get from this is an opportunity to have a further discussion, as I think Mr. Taylor was trying to say, about what the responsibilities of the credit unions should be. To me, most of the evidence I see points to the fact that credit unions have done something very good for many Americans. If it reduces the cost of obtaining credit and opportunities to expand a business or to purchase your first home, I think that is great. I think we have to continue there. But I think, Mr. Taylor, you point out in your testimony very well that, as the credit unions grow, it seems they are growing in areas that don't fulfill the mission that was first set forth for them back in the 19thirties; and that was to serve modest-income families principally. While I think many of them do a very good job, sometimes as you grow, sometimes you forget, or you lose sight of your mission. I hope that they can focus as much as possible, because I think most of us in Congress would like to continue to support not just the credit unions and the industry, but their tax-exempt status. Ms. Kennelly, a quick question for you. Mr. Taylor did propose that we consider adding CRA-type requirements or regulation over the credit industry's larger players, its larger credit unions. I am wondering if you can comment on that suggestion by Mr. Taylor?

Ms. KENNELLY. Well, I don't know what the threshold would be. I really don't have much of a comment. I think most credit unions generally fulfill those requirements without being required to do so. I don't recall what the threshold was. Do you?

Mr. TAYLOR. Yes. Well, it is different for different institutions but—May I?

Mr. BECERRA. Please.

Mr. TAYLOR. In fact—and this gets to Mr. Brady's point—the regulators really did streamline the process. This Congress dealt a lot with the regulatory burden associated with financial institutions; very recently reduced the reporting requirements as it relates to CRA. For small institutions less than—what is it, Josh, 100 million, 250 million? For 250 million, it is really——

UNIDENTIFIED SPEAKER. It started off, I think, at 50.

Mr. TAYLOR. Yes, it has grown very easily. It is a very streamlined exam, so I don't think the idea of having CRA-like requirements is going to add a terrible burden. For all these institutions that say, "We're doing it, we're doing it," they shouldn't have to worry about complying with it. But I didn't want to answer for you.

Ms. KENNELLY. Well, I answered. Originally, when all of that came up, I thought it was $50 million. We are very small.

Mr. TAYLOR. Yes.

Ms. KENNELLY. So, it is not a burning issue for me. But I do feel—believe—that most of the credit unions are complying, without the regulation being there. If it is $100 million, you will probably see some that will want to stay at 99.9.

Mr. BECERRA. I think Congressman D'Amours pointed out that in the past there was an attempt by the industry to try to have something similar to CRA applied, but that proposal—which had at first been adopted, I believe, under your chairmanship—was subsequently reconsidered. It seems like perhaps now we are finding that the fruits of that reconsideration may be coming back to haunt some of the credit union industry a bit. But I don't know if you have any comment on that.

Mr. D'AMOURS. Yes, Congressman, if you would permit me. That was my proposal. I advanced that—well, way back in '97, I believe, for the first time. You heard Chairman Johnson and other people refer to, when Congresswoman Hart and other people were asking about transparency and reporting, the 5300 report that they filed quarterly. All I was asking for in that attempt was that they add into their business plans something that would state what efforts they might make to reach out to low-income people. They called that "CRA." They fiercely resisted it. After 3 years or so of persisting, I finally got it passed. It was not an industry effort; it was an agency effort, because I was the chairman of the agency. It was repealed a month or two before it went into effect, after I left the agency. The truth is, they don't want to be looked at, and I wonder why.

Mr. BECERRA. I thank everyone for their comments. As we move forward, those of us who are very supportive of credit unions hope that this is something that can be examined further, now that we are collecting more and more data. Perhaps one of the things we should do is try to collect even more data, to give us a better sense of really where the industry is heading; and therefore we have something to compare apples and apples with. So, I thank you for your testimony. Mr. Chairman, I thank you for the time.

Chairman THOMAS. Thank you. As we conclude, I want to make some statements and ask some questions, because I think we have been dodging around some of the core structures that we have to face sometime. If other Committees, or if agencies that are seen more as enablers than regulators, aren't willing to face up to it, then I am willing to make some statements and I am willing to allow people to respond to the statements that I make. I believe—in large part, based on historical analysis—that the term "modest means" was used for a couple of reasons. "Low-income" is easily measured. It is a term that is often used inside government. "Modest means" is in the eye of the beholder. But clearly, in the thirties, when you talked about "modest means," it was a typical, middle-class structure in those days. I honestly believe Congress did not intend to include "modest means" in the credit union structure to require that not-for-profit structure reach out to low-income and racial minorities as a primary focal point in establishing a mutual credit structure.When you talk about common bond, they were all kind of the same. When you use a company with its employees, they aren't exactly low-income. It was because the banking structure at that time did not make loans, normally, to those kinds of people.

When you look at the history that we have now gone through—and we are looking at it today—for someone to respond, who is supposed to be a regulatory agency over credit unions, "We don't know what 'modest means' really means," then it is time to get serious about a definition. I believe today "modest means" would be substituted with "low-income and racial and ethnic minority." I know there is resistance if that is the definition that is used, but I cannot believe we sat through an entire hearing in which people just shrugged their shoulders and couldn't figure out what "modest means" means. It means a whole lot different today than it did in the thirties. Now, I asked the question several times: What is the primary reason for granting tax preference? The structure, which is certainly admirable, in terms of a cooperative, self-help, bootstrap kind of a concept, is not the sole reason for the exemption. It made sense at the time, because of the environment the country was in, for individuals trying to get a loan.

Today, as we have seen, there are banks who pay taxes, who have no common bond, who offer lower rates to low-income and minority individuals. Why? Because, ironically, the structure that was to provide assistance back in the 'thirties is a limitation today. Because of the structure, you are limited; and so the people who belong may not necessarily be low-income or minorities. So, the credit unions believe they have shifted to a degree by creating the opportunity for a number of common bond folk to come together, in a multiple bond; or in fact, to go out and deal with a community. I just found it almost amazing that when you talk about under-served areas, it was always geographic; it wasn't people. There was no evidence that was required to show that if you achieved moving out into this other area which was defined as under-served, that you had to show you were in fact serving the under-served.

So, one of the real concerns I have is not understanding why the credit union industry does not want transparency and accountability. In terms of seeing whether or not we are getting our money's worth, I, personally, as the Chairman of this Committee, as long as I am the Chairman of the Committee, when we are dealing with somebody who gets a tax-preferred status—as admirable as a volunteer, cooperative structure is—I am going to interpret the tax-preferred structure as meaning servicing those who are unable, either through the structure that is present or geography, to get their basic financial needs met. Today, that means low-income, minorities, racial, women, and so on; and not some "modest means" that can't be defined.

I also am quite concerned that an agency that is supposed to be a regulator appears to be, to a very great extent, an enabler which is making excuses for not being able to measure up to deliver a product which gets a tax preference. People keep talking about how tax preference isn't worth much. In fact, banks are better off than the rest. Well, then I can't figure out why you are fighting so much, worried so much, and causing so much concern about examining the question of tax preference. If it is no big deal, why are you here? So, what I really think this industry and Congress and everybody else needs to do is look at how the full panoply of financial services are providing the kinds of needs that Americans of all economic levels, ethnicities, or gender, need, and determine whether or not the taxpayers' dollars—which I think are supposed to be available to help service—are really being met.

The only way you can know that those needs are being met is to gather data to determine if the decisions you make are effective or not. I do not fully understand the defensiveness on the part of a number of people, who have been provided with new structures presumably to reach out and provide those services to certain groups of people, who seem to say that, "That isn't our job. That isn't why we are here." That probably concerns me as much as anything, in terms of the comments that have been made during this hearing. No, I don't think you should remove the tax-exempt status; but I won't put a period there. I would say where it makes sense, in terms of the historical and current use of a cooperative structure—which, interestingly enough, enabled at one time in the thirties, inhibits today to carry out your various activities. That is why I think measurements such as the community——

[Discussion in hearing room.]

Chairman THOMAS. Don't worry about them. They are perfectly willing to be rude because they have other needs they want serviced. You can do it outside the room, if you so desire.

[Pause.]

Chairman THOMAS. It seems to me that a measurement that is applied to taxable entities of financial services should be a reasonable yardstick to be applied to the tax-free area. It has to be explained to me why you shouldn't adopt it. Providing information on remuneration totally of officers and other people who are paid, to allow for transparency, shouldn't be fought. You should do it to show how reasonable and equitable the payment structure is, which reflects the membership structure, and how it appears favorably to other institutions who deal with money—unless, of course, that is not the case. Arguing that you have CPAs who collect data, which is exactly the same argument the corporations made, does not pass the oversight test. Prior to our peeling off the ugly cover we found that the relationship between the then-existing CPA structures, who not only audited but advised the financial structure where to put their money, and who then went back and looked at the structure and said it was okay.

To resist voluntarily submitting yourself to something that is an FDIC Sarbanes-Oxley similar accounting system, instead of explaining what you do have, is again something I think you need to be concerned about. Because as we have seen the concentration of money is in a select group of credit unions—I think you are beginning to see a potential of a mitosis, in terms of a broad-based, historical structure which renders a valuable service at a particular level and style of service, that may not be compatible with today's modern structure, with what they want to do and how they want to do it. To artificially gloss over those differences because you want to retain some kind of structure for its historical integrity, rather than trying to deal with the issue that is currently growing inside your structure, is something I think everybody should be concerned about. One of the purposes of this hearing, as far as I was concerned, was to get all of the different kinds of credit unions not only to talk to us, but to talk to each other; so that you can begin to understand that a single, common bond, small community credit union isn't the same as a credit union that has as its endeavor the entire County of Los Angeles, with no other bond than that you live, work, go to school, or worship there—and that that collection can pull together amounts of money that rival relatively major financial institutions, to finance office buildings, hotels, and other activities.

Then, finally, of all of the not-for-profit structures, this is the one, ironically, that has hung onto that commitment to people, tied to people of modest means. Maybe some of you fail to realize that that definition, which was never firmed up, has changed, and "modest means" means low-income, racial minorities, and women. The easiest way to show that is to use the CRA as a standard. I would just tell you, if you look at Massachusetts, which is an absolute case study of a requirement that some use and some don't, all the fog disappears. There is a bright line of who is servicing those, and who is not. Mandated; imposed—I don't care. It is taxpayers' money going to you for the purpose of carrying out a particular function. Frankly, I think a good and worthy one is to define the people of modest means along the lines of the CRA. Now, that is a very strong opinion on my part, as I said, based upon the changes that I have seen occurring and the reading that I have made. I will give anybody a little bit of time here to have a response back, if what I have said outrages you, or misses the point, or does not assist us in moving forward at the end of this hearing to try to get a handle on where we are and where we need to go.

Mr. D'AMOURS. Mr. Chairman, may I say something?

Chairman THOMAS. Certainly.

Mr. D'AMOURS. I think you are quite right in noting that it is amazing that we can't get a definition of what "modest means" amounts to. But the truth is that that is not happenstance; they want it that way. To hear somebody in this room say that everybody in this room is a person of modest means is to fundamentally misunderstand what credit unions are all about. When the credit union system was created—it goes back to Canada—people of modest means were people who didn't have access to banks. I will bet everybody in this room has access to a bank or some kind of financial institution. In that day, they didn't. All they had was loan sharks and other predatory lenders. People, if they had jobs, it was small factory jobs that weren't paying very much. The truth is, when I was Chairman, and I stressed that they should focus on low-income people, in several cases—as that Woodstock Institute, by the way, study found—in several cases, they shot back that credit unions were never really intended to serve anything but the middle class. So, it is to their advantage to deny that "modest means" means "low-income." It did mean "low-income" at the beginning, Mr. Chairman. I take slight issue with you on that, if I may. It did mean low-income people from the very beginning. The people of modest means, it was built into the credit union statute, were in fact low-income people. But I just want to say, Mr. Chairman, thank you——

Chairman THOMAS. If the gentleman would yield briefly, the reason I said it didn't was because those people were invisible back in those days.

Mr. D'AMOURS. Precisely. Precisely.

Chairman THOMAS. They really weren't low-income. They were modest means, and they thought they were low-income, but nobody looked at all the other folk out there who really were.

Mr. D'AMOURS. But I do want to say, Mr. Chairman, having hit my head up against a brick wall for 7 years as Chairman of NCUA, thank you very much for what you are doing. I hope that this isn't just going to be another rallying point for credit union trades to go out and raise a lot of money to fight the tax bogeyman, and it will result in something positive coming from the U.S. Congress. As I said earlier, if it doesn't come from Congress, it is not going to happen.

Chairman THOMAS. Thank you very much.

Mr. TAYLOR. Mr. Chairman, if I may?

Chairman THOMAS. Mr. Taylor?

Mr. TAYLOR. I, too, want to thank you, Mr. Chairman and the other Members of the Committee. I think this is a very important discussion, at least from where I sit, in trying to influence financial institutions to not overlook the needs of traditionally under-served people, or low- and moderate-income people. I do think it is a problem when the NCUA Chairperson sits in front of you and says, "I consider myself someone of modest means," because I think there is a disconnect as to—I mean, I don't know what they pay these days to the Chairman of NCUA, and maybe it is modest means; but the medium income for a household in this country is about $42,000, and I would put "modest" somewhere below that.

Chairman THOMAS. Right.

Mr. TAYLOR. Now, I know you have been cutting government budgets and cutting salaries and cutting things, so maybe you have done a lot more than I perceived. But I have got to tell you, I think the problem is bigger than simply: why doesn't the industry sort of get it, and subject itself to some transparency, some sunshine? Because while we are having this conversation, the credit union association, CUMAA, through its Renaissance Commission, in June of

2001, issued a report that was sent to its members with a recommendation that it remove the words “people of modest means” from the credit union mission statement. In that, they went on to say, “That is a clear victory. We won it. We have done it. You know, we don’t need that statement any more.” Even in the testimony today, Mr. Chairman, if you look at the CUMAA testimony on page 9, there are two paragraphs that refer to those important words, “people of modest means,” as cryptic words; a fleeting reference. In other words, trying to downplay what we all think—and I think we do—is an important part of the mission of what credit unions are about: to serve people of modest means. They are working to try to eliminate that from the mission statement. So, it is actually a bigger problem than simply—you know, they are trying to move away from that; make no mistake about it. I think this Tulane Credit Union, the El Paso, I think they do great work. I think they are, obviously, very nice people. But it is not representative of the majority of assets, of where this industry is going. I think this is an incredibly important hearing, and I really thank you again for having it.

Chairman THOMAS. Well, let me conclude with this statement. Because if in fact I advocated that we would remove the tax-exemption status, you would get something similar to what occurred here when this was just an oversight hearing, and you would see a whole lot more. I have no intention of doing that. I will tell you, though, Mr. Taylor, that transparency, accountability, verifiability, are extremely valuable tools. Because it then means somebody else determines whether or not somebody should continue to receive a tax-free status. I think what you will find is some people meet the test easily; others with difficulty, and need to change; and others, as you indicated, who wanted to drop that phrase altogether, have no interest in meeting it, and do not want transparency, accountability, or verifiability, because then they would be exposed. Right now, they are all behind the structure of the small, common bond, wonderful—I belong to one—credit union. All I tried to do with this particular hearing was to get people to realize that who comes up to the mike to talk about what is going on isn’t necessarily representative of an industry that is rapidly changing and needs transparency, accountability, and verifiability. Thank you all very much. The hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

[Questions submitted from Chairman Thomas to Ms. JoAnn Johnson, and her responses follow:]

Question: Please describe what data the NCUA collects regarding Credit Union Service Organizations (CUSOs), including their ownership and activities. How many CUSOs are there? How many are wholly owned by a single credit union? How much revenue do CUSOs generate annually?

Answer: It should be noted, as an initial matter, that NCUA does not directly regulate CUSOs. Instead, in conformance with the Federal Credit Union Act and our regulatory framework, the focus of the agency is on the credit union and its relationship with CUSOs. While we require that a CUSO’s books and records be fully accessible to us, issues such as unauthorized CUSO activity or other threat to a credit union’s safety and soundness are addressed at the credit union level. In such cases, we would require either divestiture or other remedial action to be taken by the credit union, as opposed to a direct regulatory intervention at the CUSO level.

On a quarterly basis, NCUA requires federally insured credit unions to submit the following data via Schedule D—Credit Union Service Organization (CUSO) Information—of the 5300 Call Report:

- Full/legal name of CUSO
- Value of investment in CUSO
- Amount loaned to CUSO
- Wholly owned (yes or no)
- Predominant service
- Accounting method used by the credit union to reflect the value of the CUSO on the credit union's financial statements
- Aggregate Cash Outlay in CUSO

For the third quarter of 2005, there was an aggregate of $735,219,785 reported in investments in CUSOs and $396,499,868 in loans in CUSOs. These figures reflect a mere .17% of all credit union assets, comprised of .11% from investments and .06% from loans. As reported on the third quarter 2005 call reports, there were 551 wholly owned CUSOs. Overall, 2,017 credit unions reported a loan or an investment in a CUSO. This figure includes the 551 wholly owned CUSOs.

The total number of CUSOs is approximately 750. This figure is an approximation because NCUA collects CUSO data by legal name which in order to be aggregated by number requires data analysis to remove any inconsistencies in the reporting of multi-owner CUSOs. The primary CUSO trade group, NACUSO, and credit union consulting firm Callahan and Associates jointly publish a CUSO directory that reflects the aggregated list of names. Their figure from the June 2005 *Directory of Credit Union Service Organizations* is 758 CUSOs.

NCUA believes the risk to credit unions is not in the dollar amount of investments or loans but in potential service disruptions or other reputation issues. For example, a CUSO providing Electronic Data Processing (EDP) services may represent an insignificant investment on an individual credit union's balance sheet, but the risk of disruption of service needs to be mitigated and contingencies developed. For EDP CUSOs, NCUA includes them in the annual review of data processing vendors and a sample is selected for on-site review by an NCUA Information Systems Officer.

NCUA's data collection does not capture CUSO revenue data.

Question: What information is needed in order for a credit union to obtain approval by the NCUA to engage in a business relationship with a CUSO? By law, credit unions are restricted in some of the services they can provide, however, CUSOs allow credit unions to offer such services. Is the NCUA concerned about the increased use of CUSOs, and how does the NCUA oversee these relationships?

Answer: NCUA's CUSO rule, 12 C.F.R. Part 712, sets out the requirements governing FCU investment or lending to CUSOs. NCUA expects every Federal credit union (FCU) to comply with these requirements, but does not require advance notice of, and does not issue specific approval for, a particular FCU's determination to engage in a business relationship with a CUSO. NCUA oversees the relationship and enforces compliance with its rule through the examination process. Additionally, CUSO activity is monitored from information gathered in the quarterly call report program.

Section 712.5 identifies broad categories of permissible types of activities for CUSOs. All such categories reflect the statutory requirement for CUSOs that they may engage only in providing services that are associated with the routine operation of credit unions. The Board has authority to prescribe rules for the administration of the FCU Act. 12 U.S.C. 1766(a). The loan authority for CUSOs in the FCU Act specifically reads: "[a] credit union organization means any organization as determined by the Board, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve." 12 U.S.C. 1757(5)(D) (emphasis added). Similarly, the investment authority for CUSOs in the FCU Act defines CUSOs as: "any other organization, providing services which are associated with the routine operations of credit unions . . . with the approval of the Board." 12 U.S.C. 1757(7)(I).

By contrast, an FCU has several specifically enumerated express powers, as well as the authority to exercise "such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." 12 U.S.C. 1757(17). There is some direct overlap between a FCUs authorized services and that which may be provided by a CUSO. For example, while an FCU can always do its own data processing, one or more credit unions may be able to achieve economies of scale or other efficiencies from securing necessary services through a CUSO. Similarly, one or more FCUs may secure advantages in terms of available expertise by conducting their mortgage or member business loan origination through a CUSO. Other services, for example, consumer loan origination, are not an authorized activity for CUSOs. Similarly, section 712.5 includes some activities that are not authorized for FCUs. The attached Appendix outlines each of the areas listed in section 712.5 and outlines whether the activity is one that is permissible for an FCU.

In general, NCUA is pleased with the range and extent of CUSO activity. The flexibility reflected in the CUSO rule allows credit unions to take advantage of pooled resources to obtain expertise for complex programs, such as a sophisticated consumer mortgage loan origination or business lending program. For more traditional services, use of a CUSO allows an FCU to take advantage of economies of scale in obtaining services, resulting in improved services at a lower cost for members.

Question: According to NCUA regulations, the NCUA may limit any CUSO activities at any time, based on safety and soundness reasons. How many times has the NCUA done so?

Answer: NCUA has found CUSOs engaging in inappropriate activities. These cases are dealt with by requiring corrective action to be implemented via the credit union that has investments or loans to the CUSO. Unless the corrective action is implemented, NCUA typically requires that the credit union divest itself of its investment or loan to the CUSO. Prior to September 2005, when NCUA implemented a new problem resolution tracking system, the agency did not capture data in a format that can be queried for this type of information. The resolution of CUSO related problems is documented in individual examination reports and it would be labor intensive to generate the number of instances corrective action or divestiture was required.

Two additional factors have a bearing on risk mitigation, from a safety and soundness standpoint, as between an FCU and its relationship with a CUSO. First, the extent of permissible investment by an FCU in a CUSO is limited to one percent, in the aggregate, of the FCU's shares plus undivided earnings. An FCU may lend an additional one percent to CUSOs. In the unlikely event that an FCU's financial stake in a CUSO were to become a total loss, the impact on the FCU's overall capital position would not be significant. Second, as more clearly spelled out in the CUSO rule, an FCU is required to assure that the corporate veil between itself and its CUSO is intact. In accordance with general principles of corporate law, the corporate veil insulates a shareholder from liability for the debts of the corporation.

Question: NCUA regulations also state that a CUSO may offer services beyond the list of preapproved activities and services only with the approval of the NCUA. How many such applications have been received by the NCUA, and how many of these applications have been approved, and how many have been denied?

Answer: The provisions in the CUSO rule relating to the ability to petition NCUA to request approval for a service not specifically listed in the rule have been included in subsection 7 since March, 1998. 12 C.F.R. 712.7 As the NCUA Board clarified in 2001, the examples under the broad categories listed in the rule are for illustrative purposes only and are not intended to be exhaustive. Since the adoption of the rule, we have reviewed numerous requests for interpretation as to whether a specific service, such as the referral to other lenders of loan applicants that have been turned down by the credit union and the subsequent servicing of those loans, is considered permissible under the rule. In accordance with the FCU Act, NCUA is guided in its evaluation of any such request by the consideration of whether the proposed service relates to or is associated with the routine, daily operation of credit unions.

As prescribed in the rule itself, a request for an addition to the broad categories listed in section five should be accompanied by a complete analysis and explanation of how the proposal conforms to the overall purpose and requirements of the rule, i.e., that the service relates to or is associated with the routine, daily operation of credit unions. If NCUA determines to act on the request, we would first publish notice in the Federal Register, treating the request as a petition to amend the rule, and invite public comment, which would be reviewed and evaluated before any amendment is made. Since 1998, we have received a small number of requests to amend the rule by expanding the approved listing of categories, none of which have been approved. The Board did amend the rule in 2003 to add the category of business loan origination as an approved category, but this determination, which became effective after notice and the solicitation of public comment in the Federal Register, was made by the Board on its own initiative.

Question: The NCUA chartering manual recognizes four types of affinity on which a community charter can be based: residence, education, worship, or employment in the relevant community. For how long has the NCUA recognized these forms of affinity as satisfying the requirements of the Federal Credit Union Act that an individual be "within a well-defined local community, neighborhood or rural district"?

Answer: The NCUA Chartering Manual currently recognizes four types of affinity on which a community charter can be based: residence, education, worship, or employment. 63 Fed. Reg. 72011, 72037 (Dec. 30, 1998). NCUA has recognized these forms of affinity as satisfying the requirements of the Federal Credit Union Act since various dates as reflected in Federal Register issuances. The history is as follows:

In 1989, NCUA issued a proposed rule and a final rule, Interpretive Ruling and Policy Statement (IRPS) 89–1, on its Chartering and Field of Membership Policy. In both rules, NCUA wrote: "Congress has required that a credit union charter that will be based on a tie to a specific geographic location be limited to a 'well-defined neighborhood, community, or rural district.' NCUA recognizes two types of affinity on which a community common bond can be based: residence and employment." IRPS 89–1, 54 Fed. Reg. 31165, 31170 (Jul. 27, 1989); 56 Fed. Reg. 12221, 12225 (Mar. 24, 1989).

In 1993, NCUA proposed changes to IRPS 89–1, but proposed continuing that there be: "two types of affinity on which a community common bond can be based: residence and employment." IRPS 93–1, Jul. 28, 1993. After receiving and reviewing public comments on this proposal, NCUA issued a final rule in 1994 adding the affinity based on worship. In IRPS 94–1, NCUA "recognize[d] three types of affinity on which a community common bond can be based—persons who live in, persons who worship in, and persons who work in the community." IRPS 94–1, 59 Fed. Reg. 29066, 29077 (June 3, 1994).

In 1995, NCUA proposed changes to IRPS 94–1. 60 Fed. Reg. 51396 (Oct. 4. 1995). In 1996, NCUA, after receiving and reviewing public comments, issued a final rule adding an affinity based on education, stating:

One commenter requests that students should be part of the community common bond so that persons who attend any educational institution located in a community would be eligible to join a credit union whose field of membership includes that community. The Board agrees. The Board believes that a student is working for the purpose of the community common bond and therefore a person going to school within the community boundaries is deemed to be working in the community for field of membership purposes. IRPS 96–1, 61 Fed. Reg. 11721, 11725 (Mar. 22, 1996).

In 1998, after the passage of the Credit Union Membership Access Act (CUMAA), NCUA issued proposed and final rules to implement CUMAA, retaining the four previously approved affinities. The preamble to the proposed rule stated that: "NCUA continues to recognize four types of affinity on which a community common bond can be based—persons who live, work, worship, or attend school in the community." 62 Fed. Reg. 49164, 49167, 49187 (Sept. 14, 1998). After receiving and reviewing public comments, NCUA issued a final rule in 1998. IRPS 99–1 stated that "NCUA recognizes four types of affinity on which a community charter can be based—persons who live in, worship in, attend school in, or work in the community." IRPS 99–1, 63 Fed. Reg. 72011, 72037 (Dec. 30, 1998).

Question: Is there any requirement that a credit union verify that a potential member prove that he works, attends school, worships, or resides in the relevant community?

Answer: Section 5 of a federal credit union's charter defines those persons eligible for membership in a community credit union. Article II, Sections I and II of a federal credit union's bylaws provide that membership applications will be signed and accepted, and approved or denied from those eligible persons. Credit unions must comply with their bylaws, and NCUA has an expectation that credit unions will only serve individuals who qualify for membership.

It is standard practice for credit unions to maintain completed signature or membership cards for their members. A sample signature card form is provided to credit unions in Section 707, appendix B of NCUA's Rules and Regulations. The sample form includes a statement by the member certifying he or she is within the credit union's field of membership. In the Supervisory Committee Guide for federal credit unions, Supervisory Committees are tasked with ensuring adequate internal controls exist over share accounts. The testing of new member signature cards for proper member qualification and approval is one element of signature card control itemized in the Internal Control Checklist for share accounts. NCUA examiners consider such testing during their normal review of Supervisory Committee activity, and also during their own review of share accounts. Chapter 14 of NCUA's examiner guide sets forth the examination objective to determine share account programs meet all legal requirements.

[Question submitted from Mr. Johnson to Ms. JoAnn Johnson, and her response follows:]

Question: A majority of the House delegation from Texas, including myself, sent letters to the NCUA detailing our concern with what appeared to be unnecessary regulatory obstacles thrown in front of two Texas-based credit unions in their attempts to convert to for-profit, taxable banks. After having to go back and forth through the courts, the credit unions were finally allowed to convert to banks. What I'd like to know is what steps, if any, the NCUA is taking to ensure credit unions which choose to convert to tax-paying, for-profit banks are able to do so?

Answer: NCUA fully supports the legal ability of credit union members to change the charter of their financial institution under the Federal Credit Union Act and NCUA regulations and acknowledges that NCUA's regulatory role is limited to oversight of the methods and procedures of the vote. In carrying out its responsibility, NCUA believes complete and accurate disclosures for members are crucial to a fair and legal vote and members are entitled to know the effects a conversion to a mutual savings bank will have on their ownership and control of their financial institution.

[Submissions for the record follow:]

Statement of Walter C. Ayers, Virginia Bankers Association, Glen Allen, Virginia

Should the Wright Patman Congressional Federal Credit Union and the United States Senate Credit be using their tax-exempt status to compete in the private sector, providing services to non-government entities? Well, they are, as are many other government based credit unions that have chosen to morph away from their roots. Therefore, we believe that it is most appropriate that the Ways and Means Committee is conducting hearings to examine the role of the tax-exempt sector in our economy, including the wisdom of continuing the tax exemption of credit unions that have morphed into bank-like institutions

Credit unions have already captured 25% of the deposit base in the Commonwealth of Virginia, and are growing deposits at almost twice the rate of banks. While it is a process that seems to be happening below the public policy radar screen, deposits are being transferred from taxpaying institutions over to tax-exempt institutions at a rapid pace.

With respect to morphed credit unions, there are two significant developments in Virginia. First, are all of the aggressive growth credit unions that were government and military based when created, that have left their original mission, in some cases changed their names to conceal their former purpose, and now use multiple and community common bonds to serve the general public. The second development is the evolution of the same thing for specific industry based credit unions. Many of these credit unions now bear no resemblance to the purpose for which they were originally created.

Ironically, the abandonment of original mission, and the use of the tax-exemption to compete in the private sector, starts right inside the United States House of Representatives with the Wright Patman Congressional Federal Credit Union, a $435 million asset credit union that most would assume exist to serve members of the U.S. House of Representatives and staff. In fact, Congressional Federal has adopted a multiple common bond approach and morphed away from its original purpose. It is now using its tax-exempt status to market its services to Virginia based private sector employee groups that have absolutely nothing to do with the House of Representatives or with government. Indeed, Congressional Federal, as is typical of those listed below, states on its web site "we have a wide variety of groups in our membership including law firms, health organizations, software companies, and many others." Was it the intent of the U.S. House of Representatives, when it authorized the creation of its credit union that its tax-exempt status be used to serve law firms, software companies, etc.? One would surely hope not.

Based on information published on their web sites, I list below additional examples of credit unions headquartered in Virginia that have capitalized on their tax-exempt status to make the same strategic shift away from original purpose as has Congressional Federal.

- The United States Senate Credit Union is now a $338 million asset institution that now uses a multiple common bond to serves numerous private sector employee groups that obliviously have nothing to do with the U.S. Senate.
- The State Department Credit Union, an $814 million asset credit union, has stepped well beyond its roots, and now serves disparate private sector groups outside the Department.

- Northwest FCU, a $1.402 billon credit, apparently began as a credit union to serve employees of the CIA. Today, it serves some 300 non-government groups in high income northern Virginia. All that is required by this credit union for an employee group to become a part of its common bond is for a company to send in a letter on company letterhead.
- Langley Federal is a $1,099 billion credit union that has morphed from a credit union serving Langley Air Base to a general purpose depository institution that now uses a multiple common bond to serve whomever it chooses to enroll, largely by adding private sector employee groups.
- ABNB is a $324 million credit union. It was formerly the Amphibious Navel Base Credit Union, but has now morphed into an institution that uses a community common bond to serve the general population across eight Virginia counties and cities.
- Chartway FCU is a $1,033 billion asset credit union that was originally the Navy Air Credit Union. Over the years, it left its military anchor and morphed into a multiple common bond credit union serving over 600 different employer groups. Now, they simply advertise that they serve anyone that lives where they have branches across five states.
- Commonwealth One, formerly the Army Air Force Annex #1 Credit Union, is now a $225 million credit union serving over 100 wide ranging groups, mostly private sector, that have nothing to do with the origins of this credit union. Plus, this credit union now claims a community common bond involving four counties and cities.
- 1st Advantage FCU started as the Fort Eustis Credit Union. Today it has morphed into a $425 million asset general purpose institution that advertises that it serves anyone who lives on the Virginia Peninsula.
- Pentagon Federal is a $7,974 billon credit union established to serve the military. It now uses a multiple common bond to serve private sector employee groups.
- The University of Virginia Credit Union, a $314 million credit union, no longer makes any pretense of existing to serve University of Virginia employees. It now has a community common bond and serves the general public across eight counties and cities.
- The Virginia Credit Union, with $1.240 billon in assets, no longer limits itself to serving government employees. It now has a multiple common bond and has already enrolled over 225 employer groups, most of which have nothing to do with government, and like so many other credit unions, this credit union is tapping into higher income groups—insurance companies, doctor groups, law firms, etc.

1. Apple FCU had its origins as a government based credit union for teachers. Today, it is a $773 million asset credit union that serves a large number of disparate, non-teacher groups in Northern Virginia that range from the Bar Association to software companies.

- Member One FCU, a $318 million asset credit union, is the former N&W Railroad credit union. This credit union left its original mission and now serves several hundred major employer groups, PLUS geographic areas involving 14 Virginia counties and cities.
- DuPont Community is a $507 million asset credit union that has abandoned its mission of serving DuPont employees and now has a community common bond to serve the public across a 11 county and city region.
- Newport News Shipbuilding Employees' Credit Union, an $883 million institution, is no longer for shipbuilders. While its sponsoring company is primarily a defense contractor, this credit union now has a community common bond, and serves the general public across a 16 county and city geographic area.

To give you an idea of the magnitude of what is happening, 15 credit unions now control 83% of total credit union deposits in Virginia. Five of the ten largest depository institutions headquartered in Virginia are now tax-exempt credit unions. Stated simply, there is a new breed of aggressive growth credit unions that offer virtually everything a bank can offer, and they have been given an open field to serve the public. The one thing that has not changed is they get to keep their tax exemption. The tax exemption has become a reward to this new breed of credit unions for abandoning original mission. It is a reward for adding doctors, lawyers, accounts, IT firms, etc., to the list of groups served. In effect, it is a reward for legal redlining, that is, carving high income groups into a multiple common bond while ignoring the underserved. It is a reward for obtaining a community common bond and serving the general population. In short, the tax exemption has become a reward for aggressive growth credit unions for no longer serving "people of small means", which was the original intent of credit unions. Little wonder that the GAO concluded that banks do a better job than credit unions of serving the underserved.

Does anyone believe the above illustrated developments were intended when the tax exemption was granted credit unions in 1937? I don't believe so. Is it not time to tax this new breed of aggressive growth credit unions that have morphed into bank-like institutions? Surely it is.

Navy Federal Credit Union
Vienna, Virginia 22180
November 10, 2005

The Honorable William M. Thomas
Chairman
Committee on Ways and Means
U.S. House of Representatives
2208 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

On Thursday, November 3, 2005, in his testimony before the House of Representatives Committee on Ways and Means regarding the "Review of Credit Union Tax Exemption," John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC), attacked Navy Federal's record of lending to minorities, low-income borrowers, and women. NCRC often appears to slant its research findings to support its predetermined conclusions. In the past, we have brought errors in NCRC's data analysis to its attention and offered to meet with Mr. Taylor to discuss inaccuracies in its analyses and issues related to how best to serve low income, minority and disadvantaged borrowers. NCRC has not responded to our inquiries and invitations.

Navy Federal has an outstanding record of serving women, minority, and low- to moderate-income members of the credit union. A principal example of our commitment to serving all of our members, regardless of race or gender, is our history of mortgage loan approvals. Our percentage of loan denials of women and minority applicants is consistently well below the average of other mortgage lenders nationwide as evidenced by the following table:

Year	National Black Denial	Navy Federal's Black Denial	National Hispanic Denial	Navy Federal's Hispanic Denial	National Women Denial	Navy Federal's Women Denial
2004	30.50%	17.05%	23.61%	11.32%	23.47%	12.15%
2003	27.85%	15.65%	21.56%	10.06%	19.15%	9.22%
2002	24.70%	7.58%	19.16%	6.00%	16.45%	3.47%

Additionally, Navy Federal has taken several specific steps to assist low- to moderate-income and minority members in obtaining financing for their mortgage loans:

- Counseling—Employees provide detailed counseling and education to members to make certain they understand the homebuying and mortgage loan process. In addition to face-to-face and telephone counseling, we also conduct Homebuyers Seminars in areas where we have concentrations of members. These seminars are directed to first-time homebuyers.
- Low Cost Loans—Navy Federal does not charge any "junk fees" on our mortgage loans, and we always strive to provide the lowest rate possible to our members. We also have loan programs that do not require private mortgage insurance for loans with low down payments. These considerations allow more members to qualify for our loans by reducing their monthly payments and out-of-pocket costs.
- Minority Loan Review Committee—A group of minority employees review all loans to minorities that are denied. This insures that there are no hidden biases in Navy Federal's underwriting decisions.
- 100% financing—To assist first-time homebuyers, Navy Federal offers a program with no down payment required.
- HELPER loan—Navy Federal is getting ready to introduce this CUNA mortgage program that offers a 3/1 ARM loan, at 1% below market, to borrowers with low incomes.

I respectfully request that this letter be included in the record of the testimony presented to the House Committee on Ways and Means, Thursday, November 3, 2005.

Navy Federal has a proven record of fair lending, and I am confident that the needs of our entire membership are being well-served.

Sincerely,

Cutler Dawson
President/CEO

National Association of Federal Credit Unions
Arlington, Virginia 22201
November 17, 2005

The Honorable William M. Thomas
Chairman
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

Dear Chairman Thomas:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association that exclusively represents the interests of our nation's federal credit unions, to submit information for the record of the hearing on the "Review of the Credit Union Tax Exemption" that was held November 3, 2005.

Two issues were raised at the hearing on which we would like to comment on further—credit union transparency and credit union service to those of modest means.

There appeared to be some confusion during the hearing regarding the transparency of credit union financial reporting. NAFCU wants to stress to that there is full and complete transparency with respect to credit union finances. All federally insured credit unions must file with the National Credit Union Administration (NCUA) a form 5300 Call Report on a quarterly basis. The call report—a public document—includes comprehensive credit union financial data. (A copy of the call report of Navy Federal Credit Union, downloaded from NCUA's Web site, is attached.) A number of independent rating firms use this public data to rate individual credit unions (e.g., IDC Financial). We would also note that over 87 percent of federally insured credit unions' annual audits are performed by external auditors or by state-licensed persons.

As you will note from the attached 5300 Call Report, it includes detailed information about real estate loans (Schedule A), member business loans (Schedule B), investments (Schedule C), credit union service organizations (Schedule D), borrowings (Schedule E), savings (Schedule F), off-balance sheet commitments (Schedule G), information systems and technology, and other miscellaneous information (e.g., new programs or service offerings). We would also note that in some areas the credit union call report contains more information than that provided by other financial depository institutions. For example, details on loan maturity and interest rates charged are not collected on the public reports submitted by other depository institutions.

In addition to the 5300 Call Report, federal credit unions must, under the Federal Credit Union Act, adopt bylaws. Credit unions may adopt the 1999 bylaws as set forth by the NCUA, a previous edition of the NCUA bylaws, or a combination thereof, and the credit union may also request from NCUA approval for bylaws amendments.

Subsection 6(c) of Article VII of the 1999 bylaws promulgated by NCUA states: ". . . the financial officer will: "Within 20 days after the close of each month, ensure that a financial statement showing the condition of this credit union as of the end of the month, including a summary of delinquent loans, is prepared and submitted to the board and post a copy of such statement in a conspicuous place in the office of the credit union where it will remain until replaced by the financial statement for the next succeeding month."

As an example, a copy of Navy Federal Credit Union's statement of financial condition as of October 31, 2005, downloaded from Navy Federal Credit Union's website, is also attached.

We would also like to address the issue of service to people of modest means and minority populations. While not the subject of the hearing, we find it ironic that the banking trade associations (ABA, ACB, ICBA) would appear before the committee to criticize credit union service to those of modest means when the financial institutions represented by their witnesses granted a total of 13 mortgage loans to minority households in 2004, according to the most recent HMDA data.

I have attached a copy of a chapter from NAFCU's 2005 Report to the Board of Governors of the Federal Reserve that addresses in further detail how credit unions are serving the underserved. As detailed in the attached, there are more low-income-designated credit unions and underserved areas being added by credit unions each year. In addition, when compared to banks and thrifts, credit unions approve real estate loans that are smaller in size, approve a greater percentage of conforming real estate loans and have a greater percentage of real estate borrowers with less than $40,000 in income.

Finally, our analysis shows that when credit unions grant mortgage loans to households with under $40,000 in income, or to minority households, a significantly fewer number of credit unions are charging 3 percentage points or more above the Treasury benchmark, a new area of HMDA data reporting in 2004. This again demonstrates the benefits that credit unions provide their members over and above that provided by other financial depository institutions.

We thank you for this opportunity to add these comments to the record of this hearing. NAFCU looks forward to working with you on this and other matters as they arise. Should you wish to discuss these matters, please feel free to contact Brad Thaler, NAFCU's Director of Legislative Affairs, at (703) 522–4770, ext. 204, or me at (703) 522–4770, ext. 215.

Sincerely,

Fred R. Becker, Jr.
President and CEO

California Credit Union Leagues
Rancho Cucamonga, California 91730
November 15, 2005

The Honorable William M. Thomas
Chairman, Committee on Ways & Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Thomas:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to submit a letter for the record regarding the Committee's Hearing on Review of the Credit Union Tax Exemption held on November 3, 2005. Together, the California and Nevada Credit Union Leagues represent the largest state trade association for credit unions in the United States, serving 500 member credit unions in California and Nevada with 9 million members.

This letter will address several false and misleading claims made by credit union critics during the hearing, as well as describe how credit unions remain true to the mission for which they were created.

Credit Unions Are Serving Those of Modest Means

Despite misleading claims to the contrary made during the hearing, credit unions are proactively serving their current members of modest means, and making impressive strides in attracting potential members in this group to join credit unions.

A Filene Research Institute publication titled "Who Uses Credit Unions" (updated 2004; originally published in 1999), which uses Federal Reserve data, showed that the average net income, financial assets and net worth of people using only (or predominately) credit unions are all below those of people using only (or predominately) banks. The average household income for those using only banks was $76,923, while the average household income for those using only credit unions was $42,664. The median net financial worth of those households using banks only was $21,500, while the median net financial worth of those households using credit unions only was $7,900. The Filene Research Institute also reports that the average credit union member typically has modest loan and deposit balances:

Auto loan balance, $11,900; Business loan, $142,500.

Signature loan balance, $2,200; Savings account, $2,000.

First Mortgage loan, $99,700; Checking account, $2,200.

Home Mortgage Disclosure Act (HMDA) data consistently shows that low-income borrowers are substantially more likely to be approved for a mortgage at a credit union than at any other type of lender. In 2003, credit unions nationwide approved 72.2 percent of home mortgage loans to low-income borrowers (up from 69 percent in 2000). By contrast, non-credit union lenders nationwide approved only 47.8 percent of such loans (up from 46 percent in 2000). In 2003, credit unions denied 15.6 percent of mortgage loans to low-income borrowers. Non-credit union lenders denied 27.7 percent of loans to low-income borrowers. Viewed another way, the approval rate for mortgages is 151% higher at credit unions than at other lenders. These approval rates hold true for credit unions in every state.

A significant way credit unions provide value to those of modest means is through the pricing of their services. Numerous studies and reports show that credit unions charge fewer and lower fees than do banks for the same kinds of services.[1] In particular, minimum balances to avoid fees are typically much lower at credit unions than at banks. Lower rates on loans, especially on used cars and small loans, are another way credit unions serve those of modest means.

A Woodstock Institute report comparing the terms and conditions of the nation's 10 largest banks and 10 largest credit unions found that the credit unions performed better in terms of interest rates, late fees, over-the-limit penalties, grace periods, and disclosure in terms.[2] In explaining why the huge difference in fee structures between the two types of financial institutions, the report cited two factors: 1) credit unions' nonprofit cooperative structure, which leads to a different cost structure than banks; and 2) the credit union mission. "Their mission," the report noted, "is one reason why credit union-issued credit cards might have different terms than cards issued by other financial institutions." As the Woodstock report illustrates, credit unions continue to adhere to their original mission to provide working people with access to affordable financial services.

For decades, most credit unions could generally only offer membership to people who were part of an occupational group. This had the effect of limiting credit union access to members of modest means. However, the passage of the Credit Union Membership Access Act in 1998 gave occupational-based credit unions a streamlined way to add geographic areas to their memberships that are "underserved" (not based on occupational bonds). This provision gave credit unions a greater opportunity to serve persons from all walks of life—including the lowest income levels. In other words, more people—especially those in low or moderate income areas—have only recently become eligible for credit union membership. Since 1999, more than 650 federal credit unions have added 1,406 underserved areas to their fields of membership. In the three years ending December 2003, credit unions that added these underserved areas experienced membership growth over three times that of other credit unions (17.4 percent vs. 5.2 percent over the three year period).

While credit unions remain committed to serving those of modest means, we must point out that credit unions could not remain viable if they served only those of low or moderate income. As financial cooperatives, credit unions provide services and benefits for its members in proportion to what its members contribute to it. In other words, to have a viable cooperative you must have those who "have" and those who "have not." A credit union cannot provide loans to its members unless other members have made deposits from which to loan. We believe credit unions should provide all members the same opportunity to improve their financial well-being.

Big is Not Bad

We would like to address a misunderstanding introduced during the hearing that larger or more complex credit unions have strayed from their original mission and are therefore undeserving of their tax-exempt status. There is no legal or historical basis for this view. The tax exemption Congress granted in 1937, and upheld in 1951 and 1998, was not related at all to the size of the institution benefiting from it. It was based primarily on the cooperative structure of credit unions (i.e., member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors).

Do other tax-exempt organizations risk losing their tax exemption when they get "too big?" For example, should the Red Cross be subject to taxation because they've grown larger than small, local organizations that also provide relief or charitable services? Larger credit unions are still democratically controlled, not-for-profit institutions in every way that smaller credit unions are. A larger credit union may be more likely to offer a broader array of services, and have larger presence in a local market, but this does not make it less a cooperative organization than a smaller credit union.

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[1] 2004–2005 Credit Union Fees Survey, CUNA. Big Banks, Bigger Fees2001, U.S. Public Interest Research Group. New Jersey Department of Banking and Insurance, various surveys. The Money Talks Personal Finance Advice website at www. Moneytalks.org.

[2] Blindfolded Into Debt: A Comparison of Credit Card Costs and Conditions at Banks and Credit Union, Woodstock Institute. July 2005.

It's also important to note that the credit union tax exemption was not granted and reaffirmed by Congress on the premise that credit unions must offer only limited services to their members. Congress has never suggested that credit unions forgo pursuing technological improvements to their systems, or ignore consumer demand for more convenient services, in exchange for tax exemption. The argument that larger credit unions should be taxed simply because they offer similar services to many banks ignores the fact that the tax exemption was granted and upheld based on the *organizational form of credit unions* and *not* on a credit union's size or sophistication, or the degree of competition it may provide to other financial institutions. To view it from another angle: it doesn't appear that banks are subject to taxation because of the array of products and services they may offer, they are taxed because of their structure—that is, they are non-democratically-controlled, profit-maximizing organizations.

The economies of scale of larger credit unions make it possible for them to offer more affordable and responsive services to members of modest means. The presence and cooperation of larger credit unions enables smaller credit unions to access infrastructure such as shared ATM networks (e.g., CO–OP Network), the corporate credit union system, group lending programs, and shared branching. (Shared branching allows credit union members to conduct transactions on their accounts at any credit union that belongs to the shared branching network. We would like to clarify that shared branching does not, however, involve shared membership. Members are permitted to obtain loans and other services only at credit unions to which they belong.) The size and efficiency of larger credit unions allows them to provide all of their members—including those of modest means—with lower loan rate and fees and higher dividend rates.

Larger credit unions are also more able to offer special programs benefiting low- and moderate-income households. In CUNA's "Serving Members of Modest Means" Survey Report, published in 2003, when asked how many of up to 18 services geared to low-moderate income households were offered, only six percent of credit unions with assets below $20 million offered at least half of the services. Fully 42 percent of credit unions with assets over $500 million offered most of the services. The survey also showed that larger credit unions are also more likely than smaller credit unions to participate in outreach activities to attract low/moderate income members, and to have added underserved areas to their fields of membership.

Credit Unions are Not Mutual Savings Banks

During the hearing, some witnesses attempted to suggest that credit unions are no different from mutual savings banks and, since mutual savings banks pay federal taxes, credit unions should be taxed, too. Although many savings banks and S&Ls are mutually owned, there are key differences in structure and operation that continue to make credit unions unique.

Mutual savings banks lost their tax exemption in 1951 not because they had become "too big" or too similar to other financial services providers, but because they had lost their "mutuality," in the sense that the institutions' depositors did not exercise democratic control of the enterprise. Specifically, Congress found:

- *Mutual savings banks had evolved into commercial bank competitors.* Unlike 1951, however, there is no evidence that today's credit unions are a competitive threat to banks or thrifts. In fact, the FDIC reports that banks have enjoyed record profits each of the last four years. The real competition in the banking industry has been taking place between small and large banks. Since 1993, small community banks have lost nearly half of their depository market share to the largest 100 U.S. banking institutions, while credit unions have maintained the same depository market share.[3]
- *Mutual savings banks had engaged in widespread proxy voting schemes.* Federal credit unions are prohibited from using proxy votes under the Federal Credit Union Act (12 USC 1760), while mutual savings banks continue to use proxy voting. Thus, in a mutual savings bank, the board, which directs all policies and operations of the institution, can be elected through control of the proxies. The OTS clearly states the practical application of this practice in their *Regulatory Handbook* (Section 110, Capital and Stock Ownership):
- "In practice, members delegate voting rights and the operation of federal mutual saving associations through the granting of proxies typically given to the board of directors—or a committee appointed by a majority of the board."
- *Mutual savings banks were not democratically controlled* (voting was based on the size of each member's deposit). Even today, under OTS rules, mutual sav-

[3] Source: FDIC, NCUA, U.S. Census Bureau

ings banks can—and often do—apportion voting privileges based on one vote for each $100 in an account, up to 1000 votes. In 1998, OTS changed its regulations to permit mutual savings banks to amend their bylaws to allow from one to 1000 votes per member. In direct contrast to this practice, each credit union member has always had one vote, regardless of the amount they have in the credit union.

So, while some mutual savings banks may tout that they are "community and employee owned," it's unlikely that their depositors enjoy the equal ownership and voting rights afforded to all credit union members. In fact, what the OTS and the courts have said about ownership "rights" of federally chartered mutual thrift depositors clearly support this. An illustrative case is *Ordower v. Office of Thrift Supervision,* where mutual bank depositors challenged the OTS's approval of a conversion from a mutual savings bank to stock form.[4] The court stated:

"Nominally the customers own the mutual, but it is ownership in name only."

The OTS' Regulatory Handbook also states:

"The ability to exercise control over a mutual savings association by its members is not coextensive with the rights of stockholders of ordinary corporations." (Section 110, Capital and Stock Ownership)

Other key differences between credit unions and mutual savings banks include:

- *Not for Profit:* Credit unions are not-for-profit financial cooperatives, while mutual savings banks operate for the mutual profit of their owners. Indeed, given the limited rights of depositors of mutual savings banks as described above, the only thing "mutual" about mutual savings banks appears to be the way they operate for the mutual profit of their owners.
- *Volunteer service:* Most credit union boards of directors serve voluntarily and are unpaid. Board members are elected by and from the credit union's membership. Mutual savings banks have paid directors.
- *Limited market:* Credit unions are restricted by statute to a limited field of membership composed of specific groups or those in a geographical area. Mutual savings banks have no such restrictions.
- *Limited powers:* Credit unions are the most heavily regulated of all financial institutions. They must operate within limitations on business lending, loan interest rates, loan maturities, investments, and a host of other restrictions that don't apply to mutual savings banks, and are not allowed access to capital markets.

CRA is Not Appropriate for Credit Unions

Banks are subject to the Community Reinvestment Act (CRA) for one simple reason: prior to the passage of CRA, banks accepted the deposits of low-income customers but many banks routinely "redlined" poor areas as too high-risk for lending. In response, Congress passed CRA in 1977 to require financial institutions to make credit available to those who deposited funds in a given financial institution. Congress exempted credit unions because credit unions—by law and in practice—can only lend to their members (i.e., those who belong to a given credit union).

CRA is not appropriate for credit unions for some of the following reasons:

- Credit union data results are inherently skewed under CRA because of legal restrictions that banks or thrifts do not face:
  - Banks and thrifts have no limits on who they can serve.
  - Credit unions' outreach area is restricted by their field of membership.
  - Even "community" credit unions can only serve members.
- CUs are legally barred from providing "lifeline services" to households that are in need and are eligible for membership, but have not formally become members.
  - The result: vulnerable households face yet another barrier to accessing basic transaction services.
  - Credit unions are technically restricted from serving the very households CRA was intended to reach even though those households qualify for membership.
  - Credit unions and consumers are denied the opportunity to build trust and a longer-term financial relationship over a series of transactions.
- CRA emphasizes lending, especially mortgage and business loans.

[4] Protecting the Rights and Interests of Credit Union Members, American Association of Credit Union Leagues, August 2005.

  - Credit unions specialize in flexible savings products and consumer loans, which are much more fundamental products and services for households of modest means.
  - CRA doesn't measure consumer lending, the core business of most credit unions.
  - Credit unions face a legislated cap on member business loans of 1.75 times their net worth up to a maximum of 12.25% of assets for "well-capitalized" credit unions.
- Regulatory restrictions on credit union investments render credit unions ineligible to earn substantial CRA credits under the "investment test."
  - Credit unions cannot legally make investments in community development corporations (CDCs) or community development loan funds (CDLFs) that banks can and do use for CRA credit; credit unions are also prohibited from participation in tax-credited affordable housing bonds, the New Markets Tax Credit Program, and CDFI Fund grants of taxpayer money for community development projects.
  - Thus, credit unions cannot invest in affordable housing projects, community development centers, etcetera whereas banks and thrifts can.

In closing, the California and Nevada Credit Union Leagues would like to thank the Committee for the opportunity to provide additional information for the record regarding the unique nature of credit unions. Credit unions have by no means abandoned the statutory mandate Congress gave them in 1934 to remain modest-means focused and cooperative in nature. The federal tax exemption—its privilege and its responsibilities—motivates the decision process for all credit unions, whether they are decisions regarding members, products and services, or field of membership. We believe the evidence clearly shows that credit unions—both large and small—remain true to their original mission of providing all members with the means to build a better way of life.

Sincerely,

David L. Chatfield
President/CEO

Statement of Financial Services Roundtable

The Financial Services Roundtable believes it is necessary to examine the tax exemption of federal credit unions. There is a class of credit unions that appear to have less focus on serving individuals of modest means and a field of membership that stretches the definition of a "common bond." This, coupled with the ability of these taxpayer subsidized credit unions to offer services similar to that of tax-paying financial institutions, as a matter of competitive fairness, brings into question whether it is appropriate for these credit unions to be tax exempt. The Roundtable believes the Committee must examine this tax exemption, which is in part based on: 1) these credit unions serving individuals of modest means, and; 2) a "common bond" that defines a credit union's membership.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for $40.7 trillion in managed assets, $960 billion in revenue, and 2.3 million jobs

Serving Individuals of Modest Means?

Part of the basis for the tax-exempt status of credit unions is their service to individuals of modest means. The Credit Union Membership Access Act of 1998 states, it is in part "because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

A key question that must be examined is if credit unions are serving individuals of modest means. Based on data available credit unions serve those of modest means, but also serve a significant portion of individuals with substantial means. Based on a recent demographic survey by the Credit Union National Association the average household income of a credit union member is $55,120, which is significantly higher than the median household income in the United States of $44,389.

The Government Accountability Office in a 2003 report stated "[o]ur assessment of available data—the Federal Reserve's 2001 SCF, 2001 HMDA data, and other studies—provided some indication that credit unions served a slightly lower proportion of households with low and moderate incomes than banks." More specifically the report indicates that only 36% of households that primarily or only use credit unions are of low and moderate income, compared to 42% that primarily or only use banks.

The information available suggests that credit unions are not doing as well as other financial institutions in serving individuals of modest means.

A Broad Common Bond

Credit unions also receive a tax exemption due to the nature of their membership or specifically the common bond that is shared between members. The Credit Union Membership Access Act states, with respect to this common bond that "a meaningful affinity and bond among members, manifested by a commonality of routine interaction, shared and related work experiences, interests, or activities, or the maintenance of an otherwise well-understood sense of cohesion or identity is essential to the fulfillment of the public mission of credit unions." Today, in practice, what constitutes a common bond stretches this definition allowing for the formation of large credit unions that compete for the same customers as tax-paying financial institution in local markets.

Today credit unions that share a common occupational bond are permitted to add other occupational groups to their membership based on what has been said to be *pro-forma* approval of the NCUA. Although even more troubling is the approval by the NCUA of charters for credit unions with a large community as a common bond, which has fueled the conversion of existing credit unions to community credit unions. In 2004, there were 84 conversions to community credit unions with some having the ability to serve millions of members.

These community credit unions are typically chartered to serve people "who live, work and worship or attend schools in, and businesses and other legal entities located in" a particular area. Given the population of some of these areas there is a large potential membership pool. Some examples of credit unions converting to community charters in 2004 include:

- The LA Financial Credit Union, which will be able to serve all of Los Angeles County, California and has a potential membership of 9.6 million people.
- The Dessert Schools Credit Union, which will be able to serve all of Maricopa County, Arizona and has a potential membership of 3.1 million people.
- The Dallas Teleco Credit Union, which will be able to serve all of Dallas County, Texas and has a potential membership of 2.2 million people.
- The U.S. Credit Union, which be able to serve the counties of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott and Washington Counties, Minnesota and has the potential membership of 2.6 million members.

These four conversions account for over 5% of the population of the United States. From the end of 1999 through 2004, there have been 589 credit unions established or converted to community charters.

This ability to serve millions of people in a community, not only stretches the definition of a common bond, but creates local markets where a tax-subsidized credit union can compete community-wide with tax-paying financial institutions for the same customer.

Issue of Fairness

Today credit unions offer a full range of services and products, including commercial lending services. In essence, credit unions are indistinguishable from banks. On a local level as credit unions are able to serve whole communities it creates a competitive disadvantage for tax-paying financial institutions.

The tax-payer subsidized credit unions have a price advantage over the tax-paying institutions in competing for the same customer base. A study on credit unions in Virginia, by Professors Neil Murphy and Dennis O'Toole attributes a "67 basis point advantage in loan pricing and deposit pricing" to credit unions' tax-exemption.

If a credit union does not have to focus on individuals of modest means and is permitted to serve large communities, why should it be entitled to a tax exemption? As credit unions are permitted to serve large communities, it has the potential to create two banking systems in a local market, one that is tax payer subsidized and another that pays taxes. Fairness dictates that they similarly situated institutions be treated equally.

Conclusion

As the Committee examines the tax exempt status of credit union, the Roundtable believes it is important to pay particular attention to large credit unions that are unlimited in their ability to compete in a market for the same customers as financial institutions.

The Roundtable believes it is necessary to evaluate whether these credit unions are actually serving their intend purpose of providing services to individuals of modest means, or have greater interest in serving all members of a community through a broad common bond. It is an issue of competitive fairness as tax-payer subsidized credit unions are indistinguishable from banks and compete for the same customers. It is important to ask if the American tax-payer should continue to subsidize theses credit unions.

Statement of the Honorable Phil English, a Representative in Congress from the State of Pennsylvania

I commend Chairman Thomas and Oversight Subcommittee Chairman Ramstad for holding today's hearing to review the tax-exemption for credit unions. The oversight responsibility of the Ways and Means Committee is one of its most important roles and examining the vast corners of the tax-exempt sector falls squarely within that responsibility. A thorough assessment of the standards for tax-exemption for credit unions, as well as other tax-exempt entities, helps our Committee fulfill its responsibility to American taxpayers.

Through this process, I look forward to examining the benefits the nation receives in exchange for the credit union tax exemption. The credit unions in my home state of Pennsylvania alone, serve 3.5 million customers. In my district in the northwestern part of the state, many working class families rely on credit unions for low-cost financial services.

As we examine the structure of these not-profit credit unions, I welcome examples of the benefits credit unions consumers receive, including in the form of favorable interest rates and fees. I also look forward to receiving information regarding the demographics of credit unions' clientele.

After a comprehensive examination of their structure and benefits, I believe the Committee will find credit unions' tax-exemption is justified because they continue to fulfill the important public policy goal of providing working Americans with an affordable alternative to their for-profit counterparts.

A.M. Community Credit Union
Kenosha, Wisconsin 53144
November 1, 2005

Congressman Thomas, My name is Don Gillespie and I am fortunate to serve as the President/CEO of A M Community Credit Union (see endnote 1). While I must admit to being somewhat concerned that your committee is undertaking the review mentioned above, I also must admit that a periodic review of tax exempt organizations is an application of sound government practice. Further, I am confident that you, and your committee, will better appreciate the value of the credit union system and its tax exempt status through the hearing process. I hope to contribute to the committee's review by providing some personal views of the issue in a concise bulleted format.

The background information provided by the committee indicates that the tax status of credit unions was reaffirmed by the Congress in 1998 when the correctly prioritized their reasons;

- Credit unions remain member owned cooperatives, that individual ownership stake illustrates more than a symbolic structure, it ensures that credit unions remain more responsive to their member needs.
- Credit unions are indeed democratically controlled, one member—one vote, is a principle we embrace that enfranchises even the lowest economic sector of an individual credit union.
- Credit unions remain not-for profit entities retaining earnings sufficient to fulfill fiduciary safety and soundness standards and returning all other earning to their members through extended services or improved pricing on loan, deposit, or transaction accounts.
- Credit unions boards are populated exclusively with volunteer directors (with exception to the credit union CEO who may serve as a director). Those volunteers establish the mission and vision of their unique entities, they hire and

guide executive management, and they represent the members that elected them to office with sincerity and diligence.

- Credit union missions were sighted by the congress in reaffirming the tax exempt status of such organizations, I offer as support for the contention that the mission sighted by the congress is substantially similar to the mission of our credit union (see end note 2).

Further, the specific mention of "consumers" denoted by the descriptive "modest means", as highlighted in the 1998 record, might give committee members cause to review in more depth the financial performance of America's credit unions. To that end I offer the following (see endnote3). CUNA through a review of FFIEC–HMDA data illustrates that between 1998 and 2003 credit unions approved 68.5% of mortgage applications submitted by low income borrowers, while all other lenders approved a mere 45.3% of low income applications—low income mortgage seekers are ‡ again more likely to be approved at a credit union than a non-credit union.

Our detractors will attempt to make much of the congressional reference to consumer service and the development of some business services in some credit unions. Listen closely to the information provided; you will learn that relatively few credit unions offer business services and that business lending represents a small proportion of the credit union balance sheet. NCUA and FDIC data were used by CUNA to show that credit union share of business lending remains below 1% of the market (see endnote 4).

Admittedly credit union business lending activity has increased, yet it represents less than 1.00% share of the business loan market, I suggest that business lending activity is being driven more by a demographic change in the American consumer than the business evolution of credit unions. I believe that it is well accepted that through economic and demographic changes in the nation and the world more and more consumers are self employed.

The U.S. Bureau of Labor and Statistics http://www.bls.gov/news.release/pdf/empsit.pdf reports that the number of self employed Americans increased 72,000 during the month of September 2005 alone, that growth translates into an annualized rate of 8.40%. Of course as the downsized or outsourced middle manager begins her/his entrepreneurial journey they seek the financial institution closest to them, their credit union.

Chairman Thomas, the tax exempt status of credit unions has been and remains in the best interest of American consumers (see endnote 5).

- Any new tax on credit unions is simply a new tax on 87 million credit union members.
- Those outside interests that are calling for credit union taxation have the demise of credit unions not the best interest of Americans at heart.

The congress in 1998 sighted first and primary the reasons for credit union tax exempt status as the member owned nature, democratically controlled structure and volunteer board led reality of the credit union system. Those realities exist today in each credit union in our nation. Regardless of the field of membership or number of members, the asset size or business activity: a Credit Union is A Credit Union—we are owned by, governed by and strive to serve our members. With each member having the same voice, and earning the same high degree of respect—no matter their individual circumstance.

Please diligently review the status, purpose and operation of credit unions. Consider the source of the testimony before the committee. Weight the antagonists and protagonists testimony and you must conclude that the institution of credit unions in America is indeed fulfilling the congressional mandate and is certainly deserving of their tax exempt status.

Sincerely

Donald J. Gillespie

Endnotes

1. A M Community Credit Union, 6715 Green Bay Road, Kenosha, WI 53142, 262–697–3700.
2. Mission Statement:

To be a member driven cooperative providing a line of financial and financially related products to satisfy the needs of the people who live or work in Kenosha and Racine Counties:

- Maintaining the Highest Quality of Member Services
- Offering Competitive Consumer Financial Products
- Encouraging Full Member Participation in our Cooperative

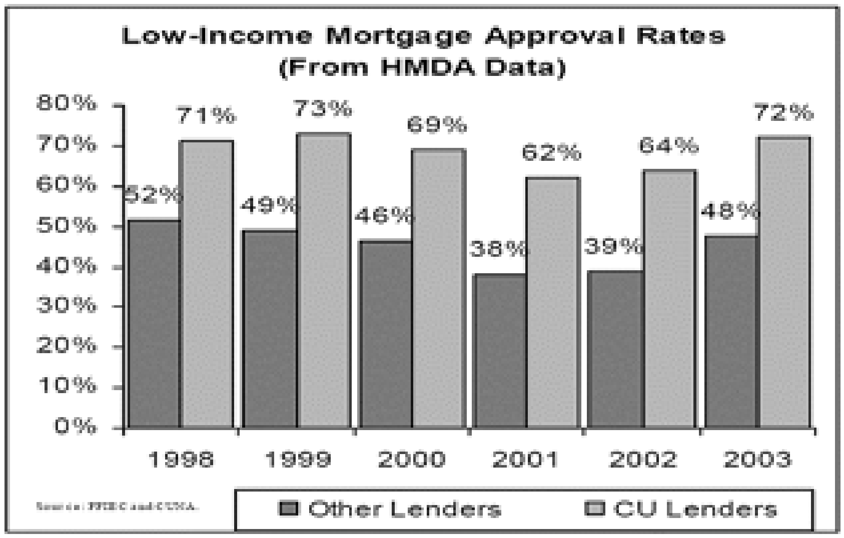
5. Tax Credit Unions? It Doesn't Add Up

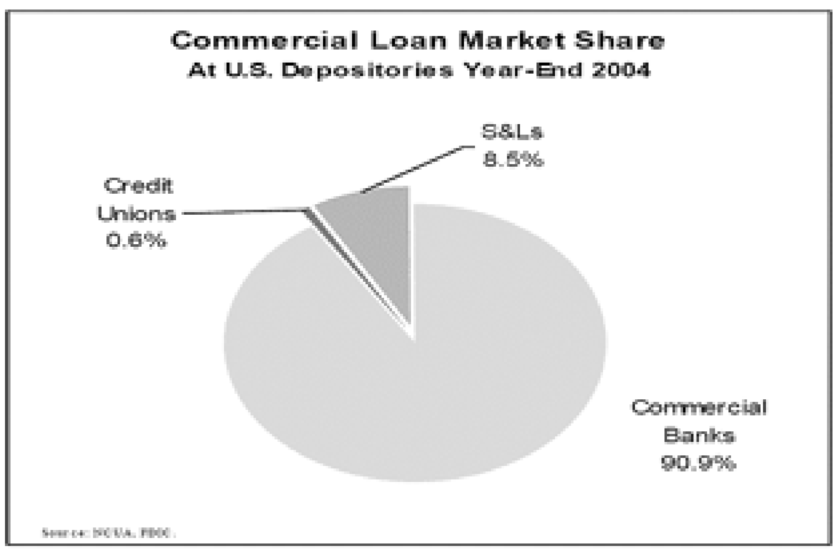
Estimated annual increase in federal income tax revenue arising from credit union taxation (a direct tax on 87 million credit union member-owners): +$1.5 billion

Estimated annual decline in credit union member benefits arising from change in tax status and subsequent operational changes*: −$6.3 billion

Estimated annual decline in bank customer benefits arising from greatly reduced influence of credit union competition**: −$4.3 billion

Net annual economic impact of credit union taxation: −$9.1 billion





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West Haven, Utah 84401
October 28, 2005

Thank you for this great privilege to submit a written statement concerning the credit union tax exemption. As a citizen of this great country, it is truly an honor to submit this statement. What a great country! Where else in this entire world would I be able to have this opportunity?

I am the father of 11 children. My wife, Shelley, and I are expecting our 12th child around Valentine's Day next year. Our oldest child is 22 years old. She and her husband recently made us the proud grandparents of our first grandchild, a girl.

I joined a credit union when I first graduated from college in April 1981. My first job out of college paid an annual salary of $16,200. I thought I was rich! My credit union provided me with savings plans that helped me save enough money ($5,000) for a down payment on a new starter home (total price $50,000), which we finished building the week before we were married in February 1982.

Our credit union has continued to provide us with savings plans that meet our modest needs. Our financial goals for our children have been to help them save and prepare for college, church missions, and marriage. Our credit union offers a unique savings plan which allows us to automatically transfer a minimum of $10 per child per month from our paycheck into each child's savings account. This "dedicated savings" account has no minimum balance requirements but pays certificate of deposit rates! Our oldest daughter will be graduating from college this year. Her "dedicated savings" account helped finance her education and also provided money for her wedding. Our oldest son recently returned from a church mission to California. His younger brother is currently serving a church mission in Brazil. While both boys were serving missions at the same time, we were paying $800 a month to cover their mission costs. Their "dedicated savings" accounts allowed us to financially support them while they were serving their missions. These accounts also helped finance the missionary in Brazil while he attended college before his mission. The missionary that served in California will be starting college in January and he will benefit greatly from his "dedicated savings" account. He has also accumulated enough money in his account in case wedding bells ring in the near future.

We are people of modest means. We are a one-income family, living on an average salary. People often ask me in amazement how we can afford to have such a large family. I always tell them that (1) we are blessed because we contribute to our church and (2) our credit union provides us the savings tools that we can't find anywhere else.

I don't know where I would be financially without my credit union. We have since used our credit union for a mortgage loan to build a modest home with 5 bedrooms. We later turned to our credit union for a refinance and a lower interest rate on that mortgage loan. With the help of our credit union, we hope to be completely debt-free many years before we retire. My credit union means everything to me. They have helped me raise 11 (soon to be 12) children to be outstanding, respectful, law-abiding, contributing citizens of this country. I feel that the United States has received something in exchange for the benefit of my credit union's tax exemption. That tax exemption has directly benefited me, my wife, and our children as credit union members.

Sincerely,

Lane Gittins

Utah Bankers Association
Salt Lake City, Utah 84111
November 2, 2005

The Honorable Bill Thomas
Chairman
Committee on Ways and Means
U.S. House of Representatives

Dear Chairman Thomas,

On behalf of the Utah Bankers Association we commend you for your courage to address the evolving public policy benefits of the tax exemption granted to some co-operatively owned financial institutions, those designated as credit unions.

The Utah State Legislature has been on the forefront of this policy debate due primarily to the actions of our state regulator to effectively eliminate the common bond membership limitations on state chartered credit unions over twenty years ago. This resulted in wide-spread tax subsidized competition to the point that the

Commissioner's actions were challenged and overturned in state court. This led to several legislative debates and even a special task force which concluded its study late last year.

As a result, the Utah State Legislature adopted a resolution endorsing a recently adopted statute that established certain large credit unions as "nonexempt" and urging Congress to consider the same approach. The resolution also identified several other inequities resulting from the federal tax treatment of federally chartered credit unions including an impingement of state's rights to collect the same state and local taxes from federal credit unions that are assessed to state chartered credit unions.

Attached is a research paper we submitted to our state level legislative task force. The research clearly shows that there were two primary reasons for the tax exemption: 1. to facilitate the extension of credit to the poor; and 2. to give credit unions the same tax treatment as other cooperatives at that time. I believe you will find, as did the Utah State Legislature that at least as it relates to the larger more complex and diversified credit unions, neither of these two justifications applies in today's marketplace. First, even as recently as two years ago, the GAO determined that banks were at least as effective if not more so than credit unions at meeting the needs of the poor. Secondly, other cooperative businesses are now taxed.

I am also attaching a copy of House Joint Resolution 1 adopted earlier this year by the Utah State House of Representatives and the Utah State Senate. Please feel free to contact me with questions.

Sincerely,

Howard M. Headlee
President

Statement of Thomas Heller, Orlando, Florida

I am writing to ask you to oppose any efforts to eliminate the federal tax exemption for credit unions. A new tax on credit unions is an additional tax on 87 million working Americans.

I have been involved with credit unions since 1989. I had been out of work for three months and had accumulated credit card debt. Once I was working again, I needed a consolidation loan to pay off my credit card. Only my credit union was willing to give me the loan and not charge a high interest rate.

Studies have shown that consumers save $6.3 billion a year by using a credit union instead of a bank. I save hundreds of dollars a year myself just in ATM fees that I do not have to pay. I also use the internet for most of my online "banking".

When I first moved to Florida, I opened a bank account with SunTrust. They charged me nearly seven dollars a month, just to bank online!

My credit union charges me nothing for online access to my money and they do not charge me three dollars every time I want to withdraw my money.

Banks are in the business of making money for stock holders. Credit unions are formed by people from similar backgrounds or employers so that they have a better way of saving money and getting loans at low rates when nobody else will loan them money.

Kent, Washington 98032
November 1, 2005

Dear Committee,

As a credit union professional in the business since 1979, I see firsthand why the House Committee on Ways and Means Chairman Bill Thomas wants to review the credit union industry tax-exemption. Several times over the years I called on my peers to operate in a fiscally responsible manner that respects our tax-exemption.

Allow me to give a few examples of how our industry dishonors the tax-exemption:

- "Volunteers" receiving $5,000 annual conference/education allowance to go to Hawaii, Caribbean cruises, Germany, etc.
- CEOs enjoying membership to exclusive country clubs and driving $70,000 luxury cars paid for by the credit union.
- Industry average fee of $22 for non-sufficient funds (NSF) when the cost associated to an NSF is estimated at $2. Strange way for not-for-profits to operate on behalf of member-owners.

- Industry charging loan interest rates in excess of the congressionally mandated 15% APR when the Fed Funds rate at 1%. NCUA, giving in to industry lobbyists, allowed a waiver so that credit unions could charge up to 18% APR even though interest rates were at 45-year lows.
- Credit unions building extravagant offices/ branches that the tax-paying banking sector cannot justify.

Credit unions serve a vital role in the country's financial services industry and should be allowed to remain tax-exempt. At the same time, congress should make credit unions more accountable for operating in a manner warranting a federal tax exemption. Again, allow me to provide a few quick examples.

- Similar to the interest rate cap, congress should mandate maximum fees charged for basic financial services such as NSF, Courtesy Pay, Returned Check services. I propose a maximum NSF/Courtesy Pay fee of three times the federal minimum wage.
- Place a maximum on the capital levels for credit unions. Credit unions with 14%, 16%, 23% are not returning the earnings back to the member-owners. From the 1930's to the 1980's credit unions successfully operated with less than 8% capital. Today, the industry average is 40% higher and at the same time fees charged to members increased more than 500%.
- Require credit unions to make available a minimum package of basic financial services without a service fee and tightly regulate user fees.

Credit unions are currently asking the House Financial Services Committee to approve H.R. 2317, the Credit Union Regulatory Improvement Act. I encourage Congress to consider some pro-member amendments to H.R. 2317 that will refocus our industry on our member-owners and keep us deserving of the tax-exemption.

I welcome the opportunity to discuss in further detail any or all aspects of this submittal.

Respectfully,

Dale Kerslake
President/CEO

Credit Union National Association
Washington, DC 20004
November 17, 2005

The Honorable William M. Thomas
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Thomas:

On behalf of the Credit Union National Association, our affiliated state associations and leagues, and America's 87 million credit union members, I appreciate the opportunity to submit this letter as a means of clarifying several issues raised in your Committee's November 3, 2005 hearing to review the federal tax-exempt status of credit unions. Please incorporate this letter into the hearing record.

In this letter, I will also address several incorrect and misleading statements about credit unions and our mission made by witnesses from the commercial banking industry. We appreciate your review of this letter and please do not hesitate to contact me or my staff if you have further questions or need clarification on any of the issues raised during the hearing.

I. TRANSPARENCY

Assertion: Credit unions are not providing adequate financial information to their members.

CUNA response: Credit unions are required by law to conduct an annual audit, and credit unions with $500 million or more in assets must have an audit conducted by an independent, state-licensed auditing firm using generally accepted auditing standards, similar to the requirement applicable to banks (12 USC § 1782(a)(6)). A federal credit union is required to publicly post its financial statements monthly at its office, and the financial report on the condition of the credit union is presented at the annual membership meeting. This is more disclosure than required by closely held community banks.

Similar to banks, credit unions are required to file a call report (Form 5300) quarterly with their regulators, which provides detailed information about the financial condition and activities of the credit union and includes aggregate information about employee compensation and benefits. The call reports for all federally insured credit unions are publicly available on the National Credit Union Administration's website.

Assertion: The fact that all credit unions do not file Form 990 with the Internal Revenue Service raises concerns.

CUNA response: As highly regulated depository institutions, credit unions are quite different from other non-profit, tax-exempt organizations in the United States. As discussed above, credit unions are subject to detailed financial reporting and oversight by examiners trained to make sure that credit unions are accurately reporting their financial condition and use of their funds. We question why any credit union should be subject to IRS Form 990 reporting.

In fact, at the November 3 hearing, we understood the IRS witness to question whether the Form 990 provides information addressing the questions raised by members of the committee. At one time, the IRS relied upon a group 990 form from NCUA on behalf of federal credit unions, and decided years ago that that form was unnecessary. And, as authorized by the Service, 22 states today provide a group 990 on behalf of state chartered credit unions in their state.

The 990 form does contain one line (line 78a) referencing the 990–T filing responsibility. As explained in our testimony on page 8, credit unions have been trying for a number of years to obtain guidance from the IRS on the possible application of the Unrelated Business Income Tax (UBIT) provisions to state chartered credit unions. UBIT is a complicated area, and as depository institutions, credit unions have some unique issues that need to be addressed. CUNA thinks it is unreasonable to expect any credit union to be filing Form 990–T forms until adequate, public guidance is issued.

Assertion: Because of possible concerns raised about some charitable organizations misappropriating funds to pay exorbitant salaries, credit unions should make public the compensation they pay their senior officials.

CUNA response: We think there is an understandable sensitivity of many credit union CEOs about having their salary publicly disclosed. More importantly, we do not consider there to be a parallel between charitable organizations which publicly solicit funds for a stated goal of carrying out charitable activities and credit unions which receive funds from their members for the stated goal of providing them a good return on their deposits and a good rate on their loans.

Volunteer, unpaid credit union boards of directors set the salary and benefits of their CEOs. They do so in a competitive environment, and draw upon surveys, such as those done by CUNA, to determine appropriate compensation packages.

Assertion: Credit unions are not subject to sufficient internal control requirements.

CUNA response: There is no basis for any statement that credit unions lack adequate internal controls, and an effective system of internal controls is a very high priority for each credit union, credit union regulators, the National Credit Union Share Insurance Fund, and private companies that provide credit unions with fidelity bond and other insurance coverage.

A review of the NCUA Examiner Guide shows that continual review and monitoring of internal controls at credit unions is expected by the credit union itself and by its examiner. Obviously, the specific internal control system in place will vary based on the size of the credit union, but the long history of the success of the credit union movement and the soundness of the National Credit Union Share Insurance Fund demonstrate that internal controls are not a problem in the credit union movement.

II. SERVING PEOPLE OF MODEST MEANS

Assertion: Credit unions underperform banks in lending to low and moderate-income and minority borrowers, and banks deny fewer loan applications from underserved populations than credit unions do.

CUNA response: The reality is that credit unions for the past two years have granted a greater proportion of their loans to low- and moderate-income (LMI) borrowers than other lenders have, in reviewing Home Mortgage Disclosure Act (HMDA) data. In 2004, credit unions made a greater proportion of combined loans to LMI borrowers (27.6%) than did all other lenders (26.6%). The credit union advantage was even greater, 29% to 25.9%, in purchase loans, an even more important type of lending to help people, including first timers, to buy homes.

We recognize the percent differentials are not dramatic, but there is a good reason why we expect to see greater increases in the near future. Until quite recently, credit unions labored under rules that primarily limited membership to occupational groups large enough to support a credit union's operations. In the 1980s, credit unions were permitted to add smaller employee groups, but significant growth of community based credit unions and permission to expand into underserved areas are a much more recent events. Thus, until very recently, unless one worked for a relatively large employer, one was unlikely to be eligible to join a credit union. Under these rules, credit unions developed into powerful sources of financial services for working Americans. It's no wonder that credit union membership became concentrated in middle and upper middle-income groups.

With the passage of the Credit Union Membership Access Act of 1998 (PL 105–219), adding additional select employee groups, taking on a community charter, or adding underserved areas to the field of membership became more feasible. However, this could not have been expected to lead to an immediate change in the income distribution of credit union members. It takes time for credit unions to reach out to new markets. It also takes time for potential members to learn of and take advantage of what credit unions have to offer.

Bankers and some community groups are misinterpreting the HMDA data if they conclude that banks deny fewer loan applications from underserved populations than credit unions do. Since credit unions actually deny far fewer mortgage loan applications across the board than other lenders, from both lower income and other applicants, the denial disparity ratio is a misleading measure of performance of lending to LMI borrowers. In 2004, 74.1% of applications from LMI applicants were approved by credit unions compared to only 51.1% at other lenders. CUNA will provide the committee with a detailed analysis of HMDA data upon request.

We note with interest that on October 31, 2005—in the same week that the banking industry testified to the committee about credit unions' "inadequacies" in serving low-income people—the banking industry sued NCUA to stop federal community credit unions from adding underserved areas to their charters. As we stated at that time, this shows that the banking industry's only real agenda is to squelch competition from more consumer-friendly institutions.

Assertion: Credit unions should not engage in business lending because it detracts from lending they can do to lower-income consumers.

CUNA response: On the contrary, the type of business lending by credit unions is very likely to create jobs for people of modest means. A credit union business loan averages about $150,000. As the U.S. Treasury Department 2001 study on business lending by credit unions reported, credit union member business loans are disproportionately made to businesses owned by households with modest incomes. Treasury reported that 25.3% of member business loans were made to members with household incomes of less than $30,000 and another 20% were to household incomes between $30,000 and $50,000.

A credit union business loan can very well be that key "helping hand" for a person of modest means to reach the American dream.

Assertion: Credit unions do not want any measurement standards imposed to evaluate their service to people of modest means.

CUNA response: When a federal credit union applies for a community charter, or adds a low-income area to its field of membership, it must submit a business plan showing how it plans to serve all segments of the community. The credit union's subsequent implementation of this plan is subject to review by NCUA examiners. Credit unions welcome this kind of oversight.

Credit unions' objections to past proposals for data collection on service to low- and moderate-income people hve been based on flaws in those specific proposals, not from any categorical rejection of some form of tailored, appropriate, and not unduly burdensome form of measurement. Application of bank-type Community Reinvestment Act (CRA) standards on credit unions is inappropriate for several reasons:

- Credit unions do not have the history of "redlining" that the banking industry does, and CRA's approach was designed largely to deal with that history.
- CRA was intended in part to address the tendency of large banks to receive deposits from one community and lend them elsewhere, even in other countries, whereas credit unions are overwhelmingly local in nature, with few opportunities to engage in this abuse.
- CRA's measurements take into account only lending activities and investments, completely ignoring the provision of low-cost depository service to promote thrift

among the underserved, which has always been a fundamental purpose of credit unions.

- CRA was designed for financial institutions that can serve any customer who comes in the door, whereas the vast majority of credit unions remain occupationally based, and thus have less opportunity to serve low-income people.

The Community Action Plan (CAP) eventually by NCUA several years ago included many of the same flaws as CRA, and was rejected by the NCUA Board. The comments made by various members of the Ways and Means Committee during the hearing earlier this month will certainly encourage further discussion on this subject within the credit union movement about a system of measurement that takes into account the unique structure, history, mission, and regulatory restrictions on credit unions.

III. COMPETITION

Assertion: Credit unions are like mutual savings banks, which pay federal income taxes, so credit unions should be taxed too.

CUNA response: Untaxed credit unions are not like taxed mutual banks. If they were alike, the simple solution for the mutual bank would be to convert to a credit union to eliminate taxation. So Congress should ask the mutual bank why it does not just convert to a credit union if both institutions are similar, rather than ask a credit union to try to explain why it's not like a mutual bank.

The honest answer is that credit unions and mutual banks differ, and differ significantly. The differences are not in the powers and services offered to consumers, because consumers everywhere expect a modern array of financial services. As our testimony explains in detail, the differences are fundamentally in structure. A mutual bank would have to limit its market, curtail its investments, stop permitting weighted voting, stop paying its directors, stop having proxy voting, and so forth. Credit unions are driven by service to their members. While mutual banks do not have the divided loyalties that banks with stockholders demonstrate, mutually organized banks clearly do not have the same mission as credit unions do.

Assertion: Many credit unions have broadened their fields of membership in recent years and grown quite large, and therefore should be taxed.

CUNA response: Larger or more complex credit unions have not strayed from their mission of providing financial services on a cooperative basis. Navy Federal Credit Union, the largest credit union in the United States, and GECU, a community credit union serving El Paso, Texas, testified about the diversity of programs they offer to meet the financial needs of members at all levels of the income spectrum. At they pointed out, for a financial cooperative for operate safely and soundly, it must have members who can save in order to have members who can borrow. In fact, economies of scale make it more likely for a larger credit union to offer more affordable and consumer-friendly services to members of modest means.

As CUNA's testimony discusses at length, the credit union tax-exemption was not granted because of small size, limited fields of membership, or limited services to the membership. Credit unions grow large because of the nature of their field of membership and their success in serving the people eligible for membership. A large credit union as measured by its aggregate assets does not mean that it is serving richer people, but more people. The largest credit unions in the country today have grown based on service to millions of workers from the military services, the airlines industry, federal, state and local governments and utility companies, among other consumers.

Assertion: Mutual thrift institutions and mutual insurance companies are taxed and have thrived, and there is no reason to believe that credit unions, if taxed, would not fare as well.

CUNA response: Taxing credit unions would erode credit unions' ability to build and maintain their net worth through retained earnings. Over time and under certain economic conditions, this erosion could present safety and soundness problems. Moreover, taxation would lead many credit unions to seriously consider whether they should convert, via a mutual bank conversion, to a stock bank. The reality is that many mutual thrift institutions have converted to stock banks over time. In fact, credit unions are getting sales pitches about the merits of conversion to mutual banks from law firms who have built a book of business on conversions and have found their potential client base notably shrinking.

The erosion of credit unions' ability to maintain solid net worth should be of particular concern to the Congress because of the unique federal share insurance program Congress created in 1984. Mutual insurance companies are not covered by a federal insurance program, and deposits in mutual thrift institutions are insured by the FDIC. Both the FDIC and the National Credit Union Share Insurance Fund are backed by the full faith and credit of the United States government.

Unlike the FDIC program, however, the NCUSIF by law requires credit unions to deposit an amount equal to 1% of their federally insured funds with the U.S. Treasury and to replenish the 1% from their retained earnings if financial troubles throughout the credit union system requires large NCUSIF payouts. As a credit union grows, it is required to add more funds to maintain the 1% level. The FDIC insurance program has no such continual support structure from the banking industry. Taxation of credit unions would require reconsideration of whether the unique NCUSIF's funding mechanism, which is beneficial to the American taxpayer, should continue.

Unlike mutual thrifts and mutual insurance companies, credit unions are run by volunteer boards, a fundamental characteristic of credit unions. This volunteerism helps ensure that management decisions are made for the benefit of members, not for the benefit of the decision-makers' own pockets. Taxation would undoubtedly also erode volunteerism since paying board and committee members would become a deductible expense.

Again, thank you for the opportunity to submit additional information for the November 3, 2005 hearing record. I will be happy to respond to any further questions you may have.

Sincerely,

Daniel A. Mica
President & CEO

Statement of Minnesota Bankers Association, Edina, Minnesota

Introduction

Chairman Thomas, Ranking Member Rangel and members of the Committee, all of us at the Minnesota Bankers Association (MBA) appreciate that the Ways and Means Committee is holding a hearing on whether credit unions should continue to enjoy their current tax advantages. We are pleased to have the opportunity to provide our comments on this very important subject.

The MBA represents more than 460 Minnesota banks, ranging in size from small community banks with $10 million in assets up to large regional banks. Of our 460 member banks, the median size is roughly $58 million in assets. Given the fact that we have such a strong community banking tradition, the credit union issue is especially important to bankers in Minnesota.

The Minnesota banks do an excellent job of serving their consumer, business and agricultural customers. Our bankers are extremely active in their communities. They give their time and resources to help make their communities stronger. And of course our banks and bankers pay their fair share of local, state and federal taxes to support our government programs.

We believe that it is absolutely crucial that Congress consider whether today's credit unions should continue to enjoy their tax advantages. Our bankers support reviewing whether there is still a solid public policy justification for the credit union industry's tax exempt status, given the significant changes that have occurred in that industry. It is important to question whether the credit union tax exemption really benefits the American public and whether it is consistent with our overall tax policy.

This issue is challenging because there are some credit unions that remain true to the original credit union concept. These true credit unions serve a fairly tight-knit group and work to meet the needs of low- and moderate-income persons. On the other hand, many high-visibility credit unions have dramatically changed. These "morphed" credit unions bear little resemblance to the original credit union concept. We would argue that these morphed credit unions should therefore lose their tax advantages.

The MBA is affiliated with both the American Bankers Association and America's Community Bankers. Both these national groups have submitted testimony on this issue. We support that testimony, and we will not repeat all the arguments included in their statements. Our statement will primarily address two major points, focusing on the Minnesota marketplace.

I. Many complex credit unions operate in a manner that is not consistent with the original credit union concept, meaning they should lose their tax exemption

II. Organizationally, mutual savings banks are very similar to credit unions, but mutual savings banks pay taxes

I. Many Complex Credit Unions Operate in a Manner That Is Not Consistent With the Original Credit Union Concept, Meaning They Should Lose Their Tax Exemption

Morphed Credit Unions No Longer Focus on People of Small Means

Traditionally, credit unions have served people of small means. Credit unions were formed so that all working-class people would have access to credit. That focus on low- and moderate-income persons has long been held out as the public policy reason that justifies the credit union industry's tax advantages.

However, some credit unions have lost their focus. Studies show that banks do a better job of serving low- and moderate-income persons than credit unions do. The Credit Union National Association conducted a national member survey in 2002. The survey showed that the average credit union member has higher income, is better educated and is more likely to be in a professional occupation than an average non-member. Specifically, that study showed that the average household income of credit union members is 20 percent higher than that of non-members, $55,120 versus $45,790.[1]

The Government Accounting Office (GAO) also reached the same conclusion in a recent study. The GAO stated that credit unions have had a historical emphasis on serving people of modest means. However, after reviewing currently available data, the GAO found that banks more effectively serve low- and moderate-income persons than credit unions do. The GAO report stated that 36 percent of households that only or primarily used credit unions had low or moderate incomes, while 42 percent of households that only or primarily used banks had low or moderate incomes.[2] Similarly, credit unions made a higher percentage of HMDA-reportable loans to middle- and high-income borrowers and a lower percentage of these loans to low- and moderate-income borrowers than banks did.[3]

Consistent with those national statistics, we see specific examples where Minnesota credit unions specifically target wealthy people.

- Think Federal Credit Union is headquartered in Rochester, MN. That credit union's 2003 Annual Report states, "Yesterday our challenge was to provide financial services to members who could not get services elsewhere. Today our challenge is to provide financial services to members who can get services anywhere." This $1.1 billion credit union has clearly lost its focus. Should it continue to receive tax advantages so that it can compete directly against tax paying financial services providers for the same customers?
- Topline Federal Credit Union is headquartered in Maple Grove, MN, a fast-growing suburb of Minneapolis. This credit union actively markets its "Big Toy Loans" so that its wealthy members can buy expensive luxury items like motor homes, powerboats and sailboats. www.toplinecu.com/services/loans.htm.
- South Metro Federal Credit Union, headquartered in Prior Lake, MN, also actively markets to the wealthy, touting its wealth management and trust services to current and prospective members at www.southmet.com/invest.htm. This credit union is also unveiling its new Travel Club, featuring Alaska and Rhine River Cruises.

These are great marketing plans, but they show how far some credit unions have gone from the original credit union mission. We argue that continuing to give tax-advantaged financial services to wealthy people is bad public policy. We do not give food stamps or subsidized housing to wealthy people. Why should wealthy people receive tax-advantaged financial services?

While we see lots of credit union marketing and outreach to the wealthy, we do not see a lot of marketing of basic financial services to low- and moderate-income persons. It would be interesting to study the credit union industry's branching patterns to see how many of the aggressive growth, morphed credit unions establish branches in low-income areas.

Morphed Credit Unions Convert From Common Bond To Huge Community Charters

Another of the original defining characteristics of traditional credit unions was that credit unions served people with a tight common bond. When all the members of the credit union worked at the same plant or attended the same church, the common bond ensured accountability. Increasingly, the most aggressive credit unions

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[1] CUNA Membership Survey, 2002.

[2] Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management. General Accounting Office, October, 2003 (GAO–04–91), p. 20

[3] GAO–04–91, p. 23.

have changed from a common bond to a large community charter. Nationally, the number of community-chartered credit unions more than doubled from 464 in 1999 to 1,051 as of year-end 2004. This trend is significant because community based, mega-credit unions bear little resemblance to the original credit union concept.

Federal law requires that any credit union that adopts a community charter must serve a "well-defined, local community." Even with the legal requirement that community credit unions must serve a "local" community, the National Credit Union Administration (NCUA) continues to approve community charters that are larger and larger. A recent Government Accounting Office report indicated that the average size of a community credit union charter approved by the NCUA increased from a population of 134,000 in 1999 to 357,000 in 2003.[4]

Many of Minnesota's most aggressive credit unions have changed from a common bond to a large community charter.

- The newly renamed SouthPoint Federal Credit Union in Sleepy Eye, MN was originally chartered to serve the parishioners of St. Mary's Catholic Church. It is now a fast-growing community credit union whose membership is open to people who live, work, worship or attend school in Brown, Redwood, or Renville Counties. See www.cuathome.coop/ASP/home.asp
- Central Minnesota Federal Credit Union, headquartered in Melrose, MN, has a large geographic territory that is nearly 75 miles wide and 100 miles long. It covers all or part of eight counties. The NCUA allowed this credit union to have a non-contiguous field of membership. In addition to its regular territory, this credit union added the affluent lakes area north of Willmar, MN. See www.centralmnfcu.org/
- Mid Minnesota Federal Credit Union is headquartered in Brainerd, MN. Its geographic territory is also more than 100 miles long and 90 miles wide and includes all of six counties and part of a seventh county. The Brainerd lakes area, some of our state's most expensive recreational real estate, is included in this credit union's territory. See www.mmfcu.org/asp/services/service—1—5.asp
- U.S. Federal Credit Union originally served military officers, but it now has one of Minnesota's biggest community charters from a population standpoint. Membership is now open to anyone who lives, works, volunteers, worships, or attends school in Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington Counties. See www.usfed.org/home/?pageLabel=home. The 2000 census showed 2.6 million people living in this area. There are over 100 cities and 49 school districts in these counties.

The vast majority of the morphed credit unions are choosing a community charter. These credit unions compete directly against banks and other financial institutions for the same customers. The members of these huge credit unions do not have the strong affinity that the members of the traditional credit unions have. These credit unions use their tax advantage to gain new members, fueling further growth and expansion. The cooperative structure remains, but as a morphed credit union grows, its members look less like owners and more like depositors of the institution. The Mid Minnesota Federal Credit Union's website is a perfect example of how the lines become blurred for these morphed credit unions. The website states that "a simple $5 deposit will make you a member/owner" of the credit union. See www.mmfcu.org/asp/services/service—1—5.asp

When you compare these morphed credit unions to banks, you see that they offer nearly identical financial products and services to the same potential customers. They have lost the main characteristics of the original credit unions, which are the very characteristics that justified their tax exemptions. These organizations can best be described as tax-exempt banks.

Morphed Credit Unions Are Making Big Business Loans

Credit unions were originally formed to serve people of small means, but many morphed credit unions are dramatically increasing their business loan portfolios. While some of these loans are relatively small loans to sole proprietors, credit unions also make large, complex commercial loans to corporations. The credit union industry's business lending has significantly increased over the past couple years. It jumped almost 50 percent in 2004. Minnesota credit unions are getting into this market, making business loans to their members and to non-members.

We can think of no public policy reason to allow credit unions to serve corporate customers. There is simply no justification for allowing corporations to receive tax-advantaged financial services. Many of the morphed credit unions are making a major commitment to commercial lending. This fundamental shift in their mar-

[4] GAO–04–91, p. 35.

keting focus shows how far they have strayed from the original credit union concept. The credit unions have introduced legislation, the Credit Union Regulatory Improvement Act (CURIA), which would allow morphed credit unions to stray even further from their original purpose by increasing their commercial lending limits. We strongly oppose that expansion.

II. Organizationally, Mutual Savings Banks Are Very Similar To Credit Unions, But Mutual Savings Banks Pay Taxes

Some credit union advocates have said that their cooperative structure justifies their tax advantages. That argument is simply wrong. Credit unions and mutual savings banks have a very similar cooperative structure, but mutual savings banks pay federal income taxes. Subchapter T of the tax code could easily be applied to credit unions, just like it is applied to other mutually-owned organizations.

The tax treatment of mutual savings banks is instructive. Before 1951 mutually-owned companies, like mutual savings banks and mutual insurance companies, were tax exempt. However, Congress repealed the tax exemption because the mutual companies had matured and were providing a broad range of products that competed directly against tax-paying entities. In 1959 the House Ways and Means Committee listed some considerations it would use when reviewing the tax treatment of an industry. Those considerations include equity and fairness and allowing free play of the market.

Applying that criteria and reasoning to the morphed credit unions, one would conclude that it is time to tax these credit unions. The morphed credit unions have seen incredible growth, due in large part to their tax advantages, and they are stable and mature. These credit unions compete directly against tax-paying banks and thrifts, so fairness and equity would dictate that similar institutions have similar tax treatment. If the banks and the morphed credit unions were taxed similarly, the free market, not the credit unions' tax treatment, would dictate winners and losers.

Like all our member banks, Minnesota's mutual savings banks compete directly against credit unions. Because their organizations are so similar to credit unions, the executives who manage our mutual savings banks are keenly aware of the significant tax advantages enjoyed by their credit union competitors.

One member of our association, Brainerd Federal Savings & Loan, has roughly $60 million in assets. This mutual thrift competes directly against four credit unions, including Mid Minnesota Federal Credit Union, which has roughly $162 million in assets. Using that credit union's publicly available data, the mutual thrift executive roughly calculated the amount of federal income taxes the credit union would have paid under Subchapter T. For 2004 the credit union would have paid approximately $490,000 in federal income taxes. Paying taxes should not have been a major problem for this particular credit union, which has been very profitable. It has also grown more than 330 percent in the last 10 years.

Summary

Again we want to thank the Committee for reviewing this important issue and for giving the MBA an opportunity to provide our thoughts. While some credit unions remain true to the original credit union mission, other credit unions have morphed into something that is significantly different. These credit unions have changed their business focus and are operating in a manner that is not consistent with the characteristics that justify the credit union tax exemption. Therefore, fairness and sound tax policy dictate that Congress should repeal their tax exemption.

Respectfully submitted,

Joseph J. Witt
President/CEO

Wisconsin Federation of Cooperatives
Madison, Wisconsin 53703
November 2, 2005

The Honorable Bill Thomas, Chair
House Committee on Ways and Means
United States House of Representatives
2208 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Thomas,

On behalf of the 6.4 million citizens of Minnesota and Wisconsin that own a cooperative, I would like to thank you for taking the time to review the differences between credit unions and other financial institutions.

I am confident that a thorough examination of credit unions' cooperative governance structure, their commitment to their communities and their not-for-profit nature will lead the Committee to conclude that further taxation of credit unions and their member/owners is not merited. Like other cooperatives, credit unions are owned and governed by those that use their services, and any change in tax status amounts to nothing more than a tax increase on 87 million Americans.

In conclusion, I would point out that Congress first granted credit unions a federal tax exemption in 1937—not because of credit unions' limited fields of membership, asset size, or types of services offered—but because they are organized and operated for mutual purposes without profit, and because they serve those who are not served by banks. Those reasons still hold true today.

Thank you for your consideration of these comments.

Sincerely,

William L. Oemichen
President and CEO

Port Orchard, Washington 98367
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Committee on Ways and Means
U.S. House of Representatives

To begin taxing a cooperative can have a major impact on numerous associations in the United States, many of them agricultural in nature. Members of the cooperatives pay taxes on their individual gains. There are only a handful of credit unions in the top 100 cooperatives.

The banking industry recognizes this advantage and many of them are converting to Limited Liability Corporations or S-corporations that have the same legal attributes as a C-corporation, however, the corporation does not pay income taxes on earnings, rather, the shareholder pays income tax on dividends on their personal income tax return.

If the Ways and Means Committee contemplates removing the credit unions' tax exemption, the same should apply to Limited Liability Corporations or S-corporations.

Respectfully submitted,

Harold Slach

North Carolina Bankers Association
Raleigh, North Carolina 27619
November 2, 2005

The Honorable Bill Thomas, Chairman
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Thomas:

The North Carolina Bankers Association (NCBA) is pleased to submit this comment in connection with the House Ways and Means Committee's hearing entitled, "Review of Credit Union Tax Exemption." The NCBA is a trade association representing all 147 banks, savings institutions, and trust companies headquartered or doing business in North Carolina.

The competitive pressure exerted by credit unions on the banking industry in North Carolina is substantial. While North Carolina banks and savings institutions welcome fair competition, the tax advantaged status enjoyed by credit unions has increasingly resulted in competitive inequalities. The problem can be traced to a new breed of credit unions which has emerged. These large, bank-like credit unions have abandoned their mandate of serving persons of modest means who share a "common bond." Instead, they now compete directly with banks for business and consumer customers and use their tax exempt status to fuel their rapid expansion.

The NCBA is extremely concerned about this development and would like to thank the Committee for examining this issue.

Here are a few examples of North Carolina-based credit unions which illustrate the competitive inequalities. The State Employees' Credit Union (SECU) is a state-chartered credit union with an immense field of membership. It has 1.25 million members, assets of over $12.7 billion, 185 branch locations, and 860 ATMs. It competes directly with almost one hundred community banks, but is 44 times larger than the average-sized community bank. Although the banking industry is larger than the credit union industry as a whole, that distinction becomes meaningless when evaluating local, head-to-head competition. Banks struggle to compete with SECU on deposit and loan interest rates because banks must factor into their pricing the costs associated with the payment of taxes and compliance with consumer protection and community reinvestment regulations that are not applicable to the credit union industry.

Another example of the aggressive, new-breed credit unions is Allegacy Federal Credit Union. It was founded in 1967 in Winston-Salem, North Carolina, to serve the employees of R.J. Reynolds Tobacco Company. Today, Allegacy has $1.09 billion in assets, over 98,000 members, and its field of membership now includes employees of over 350 businesses (along with their family members and members of their households), 23 associations, and two communities. Allegacy's Web site boasts, "Among [its] current sponsor companies are the two largest medical organizations in the southeast, three nationally prominent law firms, a number of large, well-respected advertising agencies in both New York City and North Carolina, as well as many technology businesses."

Consider Truliant Federal Credit Union, which is also based in Winston-Salem, North Carolina. Chartered in 1952, Truliant now has $1.03 billion in assets, over 178,000 members, and a field of membership that includes over 800 businesses, 24 counties in North Carolina, and communities in South Carolina and Virginia. It is hard to imagine how the common bond requirement of the Federal Credit Union Act is truly met when membership is open to anyone in nearly a quarter of the counties in the state.

Other credit unions are taking notice of these techniques. Charlotte Metro Credit Union, which has $126 million in assets and over 32,000 members, proclaims on its Web site, "If you live, work, worship or study in Mecklenburg, Iredell, or Union County you are eligible to join Charlotte Metro Credit Union." The City of Charlotte and the surrounding metropolitan region is the most populous in the state. Charlotte is also the headquarters for a number of state and national banks. The notion that Charlotte Metro Credit Union serves a clearly defined and underserved "community" is absurd.

Perhaps one of the most troubling examples is Coastal Federal Credit Union based in Raleigh, North Carolina. Coastal was originally chartered in 1967 to serve the employees of IBM Corporation. Today, Coastal has $1.54 billion in assets, over 148,000 members, and has a field of membership that includes employees of over 1,000 companies and associations as well as their family members and members of their households. Coastal promotes on its Web site the ease with which anyone can walk into a branch with $10 and become a member saying, "The Coastal Capital Club is a non-profit association established to promote the education and benefits of savings, investments, and retirement planning. By joining the Coastal Capital Club for a one-time non-refundable $10 membership fee, you qualify for Coastal Federal Credit Union membership." The National Credit Union Administration is turning a blind eye to this blatant overreaching to attract members.

These large, new breed credit unions are also aggressively seeking business lending opportunities. A March 30, 2005, article of Credit Union Times is illustrative in this regard. The article reports that Coastal Federal Credit Union launched a member business lending (MBL) division in 2003, saying, "In less than two years, the credit union has closed $120 million in MBLs and sold $63 million in business loan participations." Increasingly, Coastal has ventured into complex commercial real estate transactions above the $1 million mark "with the average loan being about $4.2 million." To get around the National Credit Union Administration's 12.25 percent of assets MBL cap, Coastal has brought in credit unions in North Carolina, Virginia, Oregon, Texas, and Florida for participations. Meanwhile, Coastal's business credit card services are described as "robust with several hundred cards in rotation with limits ranging between $25,000 and $100,000."

These highly vocal, large credit unions are clamoring for increased powers, while using the veil of regulatory relief. The Credit Union Regulatory Improvements Act of 2005, H.R. 2317, which is currently under consideration, would expand credit unions' business lending authority from the current cap of 12.25 percent to 20 percent of total assets and would exclude all business loans of less than $100,000 from the cap, up from the current $50,000 cap. The caps were put into place by Congress to help ensure that credit unions focus on serving people of modest means instead of making multi-million dollar commercial loans. The new breed of credit unions has left that mission behind and consequently the rationale for retaining their tax exempt status is no longer valid.

One argument for retaining the Internal Revenue Code Section 501(c) tax exemption that has been consistently advanced by the credit union industry is that imposing taxation would be devastating to the industry. If the credit union industries in Canada and Australia are any guide, the American credit union industry's argument is unfounded. In Canada, credit unions have been taxed since 1972, while the Australian government phased in taxation of that nation's credit unions over a three year period during the 1990s. The credit union industries in those two countries have now been subject to taxation for years, but they continue to thrive.

Another argument that has been advanced for credit unions retaining their tax exemption is that they are cooperative, member-owned and not-for-profit. As others have noted, many banks and savings institutions are also cooperatively owned and reinvest their profits in the institution or in the community. These mutual banks and savings associations lost their tax exemption in 1952 when Congress determined that they were in active competition with commercial banks. At the time, mutual banks and savings associations could not operate outside a 50-mile radius and could not offer checking accounts or commercial loans. The credit unions of today already have far broader powers than the mutual banks and savings associations had available to them when they became subject to corporate taxation.

The Credit Union National Association's own statistics indicate that credit union members have a higher average household income than nonmembers and General Accounting Office statistics also support that conclusion. A Tax Foundation study placed the tax loss from perpetuating the credit union tax exemption at $12.6 billion between 2004 and 2008. When a single American family pays more tax than the entire credit union industry, something is wrong. The new breed of credit unions opens its doors to practically anyone and can afford to sponsor sporting events and pay for multi-million dollar headquarters, but it balks at the idea of paying its fair share. The competitive inequalities which have emerged need to be addressed. The banking industry in North Carolina welcomes fair competition and thanks the Committee for examining this important issue.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Thad Woodard
President & CEO

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